GRÁNIT BANK ZRT.

CONSOLIDATED ANNUAL FINANCIAL STATEMENTS

**PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)
AS ADOPTED BY THE EUROPEAN UNION**

31 DECEMBER 2019

WITH AN INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT
(Free translation)

To the shareholders of Gránit Bank Zrt.

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements of Gránit Bank Zrt. (the "Bank", the "Company") and its subsidiaries (together the "Group") which comprise the consolidated balance sheet as of 31 December 2019 (in which the consolidated balance sheet total is MHUF 398,037), the consolidated income statement and the consolidated statement of other comprehensive income (in which the total comprehensive income for the year is MHUF 1,199 profit), the consolidated statement of changes in equity, the consolidated cash flows statement for the year then ended and the notes to the consolidated financial statements comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2019, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and they have been prepared, in all material respects, in accordance with the supplementary requirements of Act C of 2000 on Accounting ("Accounting Act") relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU.

Our opinion is consistent with our additional report to the audit committee.

Basis for opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing ("HNSA") and with applicable laws and regulations in force in Hungary. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements" section of our report.

We are independent of the Group in accordance with the applicable laws of Hungary, with the Hungarian Chamber of Auditors' Rules on ethics and professional conduct of auditors and on disciplinary process and, for matters not regulated in the Rules, with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board (IESBA Code of Ethics) and we also comply with further ethical requirements set out in these.

The non-audit services that we have provided to the Group, in the period from 1 January 2019 to 31 December 2019, are disclosed in note 34 to the financial statements.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable laws and regulations in Hungary and that we have not provided non-audit services that are prohibited under Article 5 of Regulation of the European Parliament and Committee No 537/2014 and Subsection (1) and (2) of Section 67/A of Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors].

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach

Overview

Overall group materiality	Overall group materiality applied was MHUF 69
Group Scoping	The Group consists of the Bank and two subsidiaries. Both of the subsidiaries are operating in Hungary and account for 0.26% of consolidated interest income and 0.37% of consolidated total assets.
Key Audit Matters	Credit loss allowance on loans to customers

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Materiality	MHUF 68
Determination	5% of the consolidated profit before tax
Rationale for the materiality benchmark applied	We chose consolidated profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector.

Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

We have identified two subsidiaries, which, in our view, required an audit of their complete financial information, due to their financial significance or risks to the Group. Those reporting components are the entities with significant assets.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	***How our audit addressed the key audit matter***
Credit loss allowance on loans to customers measured at amortized cost	
The net amount of loans to customers measured at amortized cost was MHUF 142,842 as at 31 December 2019, representing 35.9% of total assets. Credit loss allowance recognised in the balance sheet was MHUF 90. Management disclosed related judgements, balances and estimates in section 2.6.3 of the notes to the consolidated financial statements on accounting policy. Credit loss allowance recognised on expected credit losses is determined on the basis of subjective criteria and management is required to apply significant judgement when calculating individual and collective expected credit loss allowances. The first step in the expected credit loss calculation is to identify whether there was significant increase in credit risk. The selected indicators will determine whether a 12-month or a lifetime expected credit loss is calculated. In the calculation of individual expected credit loss, the most significant uncertainty is involved in the estimation of expected future cash flows, and in probability weighting of cash-flow scenarios, where cash flows include recoveries from both collections of contractual cash flows and from collaterals.	We understood and evaluated the entire lending process from disbursement to monitoring and to the calculation of impairment, identified the main control points, and tested their operational effectiveness, including management's approval. We performed credit review for individually significant loans on a sample basis and during this we checked the customer's rating by the Group based on credit application and monitoring documents as well as customer-related financial and non-financial information. For a sample of individually impaired loans, we checked whether assumptions, estimations and scenario weightings applied in calculations are reasonable and whether the calculations are correct. For collective loss allowances we assessed whether the methodology applied by the Group was compliant with IFRS 9 with the support of our internal modelling experts. We read the validation documents, recalculated, on a sample basis, selected model parameters and the expected credit loss allowances. We checked input data (including those for modelling parameters and those used for the expected credit loss allowance calculation), indicators used to determine whether there was

The Group applies impairment models to calculate collective loss allowances. These models quantify the probability of default, exposure at default and the loss at default as the primary parameters in the estimation of the recoverable amount, taking into account forward looking information – in line with the requirements of IFRS 9. We paid considerable attention to this area during our audit due to the significance of the amounts involved and because of the subjective nature of the judgments and assumptions that management is required to make.	significant increase in credit risk and their supporting evidence and analysed the development of credit losses. We read section 2.6.3, and notes 9., 18 and 37 of the notes to the consolidated financial statements to assess whether disclosures are in line with the applicable regulations.

Other information: the consolidated business report

Other information comprises the consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the consolidated financial statements expressed in the "Opinion" section of our independent auditor's report does not cover the consolidated business report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the consolidated business report and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If based on our work performed we conclude that the consolidated business report is materially misstated we are required to report this fact and the nature of the misstatement.

Based on the Accounting Act, it is also our responsibility when reading the consolidated business report to consider whether the consolidated business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any, and to express an opinion on this and on whether the consolidated business report is consistent with the consolidated financial statements.

In our opinion, the 2019 consolidated business report of the Group is consistent with the 2019 consolidated financial statements in all material respects, and the consolidated business report has been prepared in accordance with the provisions of the Accounting Act. As there is no other regulation prescribing further requirements for the consolidated business report, we do not express an opinion in this respect.

We are not aware of any other material inconsistency or material misstatement in the consolidated business report and therefore we have nothing to report in this respect.

As the conditions in Paragraph a) and b) of Subsection (5) of Section 134 are not met at the balance sheet date, we have nothing to state.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and to prepare the consolidated financial statements in accordance with the supplementary requirements of the Accounting Act relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting in the consolidated financial statements unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HNSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HNSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting in the consolidated financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that gives a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

We were first appointed as auditors of the Group on 10 April 2018. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 2 years.

The engagement partner on the audit resulting in this independent auditor's report is Éva Barsi.

Budapest, 17 April 2020

Éva Barsi
Partner
Statutory auditor
Licence number: 002945
PricewaterhouseCoopers Könyvvizsgáló Kft.
1055 Budapest, Bajcsy-Zsilinszky út 78.
Licence Number: 001464

Translation note:

Our report has been prepared in Hungarian and in English. In all matters of interpretation of information, views or opinions, the Hungarian version of our report takes precedence over the English version.

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CONSOLIDATED INCOME STATEMENT

Data in HUF millions

Item	Notes	2019	2018
Interest income based on the effective interest method		5,483	5,094
Other interest income		700	532
Interest income		**6,183**	**5,626**
Interest expense based on the effective interest method		2,022	2,126
Other interest expense		1,057	866
Interest expense		**3,079**	**2,992**
Net interest income	**3**	**3,104**	**2,634**
Fee and commission income		2,044	1,623
Fee and commission expense		297	265
Net fee and commission income	**4**	**1,747**	**1,358**
Net profit from financial instruments measured at fair value through profit or loss	5	1,383	1,319
Net profit from financial instruments not classified as measured at fair value through profit or loss	6	0	47
Profit from FX transactions		337	289
Dividend income	7	1	0
NET BUSINESS PROFIT		**6,572**	**5,647**
Other operating income	8	95	27
- of which: Net profit from the derecognition of non-financial assets		1	-1
(Reversal of impairment on non-financial assets		0	0
Other expenses	8	462	382
- of which: Net loss from the derecognition of non-financial assets		0	0
(Impairment on non-financial assets)		0	0
Credit loss and profit	9	-22	64
- of which: Impairment or reversal of impairment (-) on financial assets		-22	64
Provisioning or (-) release of provisions		-1	11
Profit/loss (-) on changes, net		0	0
NET OPERATING PROFIT		**6,229**	**5,217**
Personnel expenses	10	1,679	1,396
Other general administrative costs	11	2,871	2,442
Depreciation		303	139
PROFIT BEFORE TAX		**1,376**	**1,240**
Income taxes	12	258	200
PROFIT AFTER TAX		**1,118**	**1,040**
Share of parent company's owners in profit after tax		**1,110**	**1,033**
Share of non-controlling owners in profit after tax		**8**	**7**

On 22.04.2020 the Board of Directors approved the consolidated financial statements.

Éva Hegedűs — Chairman & CEO

Jenő Siklós — Deputy CEO

CONSOLIDATED OTHER COMPREHENSIVE INCOME STATEMENT

Data in HUF millions

Other comprehensive income statement	**Notes**	**2019**	**2018**
Profit after tax		**1,118**	**1040**
Profit/loss from change in fair value		91	-210
Deferred-tax effect of change in fair value		-10	21
Change in impairment on debt securities measured at fair value through other comprehensive income		0	-7
Items to be reclassified to profit or loss subsequently:		**81**	**-196**
TOTAL OTHER COMPREHENSIVE INCOME		**81**	**-196**
TOTAL COMPREHENSIVE INCOME		**1,199**	**844**
Share of parent company's owners in comprehensive income		**1,191**	**837**
Share of non-controlling owners in comprehensive income		**8**	**7**

On 22.04.2020 the Board of Directors approved the consolidated financial statements.

Éva Hegedűs	Jenő Siklós
Chairman & CEO	Deputy CEO

CONSOLIDATED BALANCE SHEET

Data in HUF millions

Item	Notes	31.12.2019	31.12.2018
Assets			
Liquid assets and equivalent	13	8,846	8,915
Receivables from the MNB	14	96,525	82,103
Interbank placements	14	35,972	41,271
Securities	15	84,952	73,730
- of which: Held-for-trading securities		36,630	15,632
securities measured obligatorily at fair value through profit or loss, not held for trading		49	
Securities designated as measured at fair value through profit or loss		35,222	43,504
Securities measured at fair value through other comprehensive income		8,779	9,460
Securities measured at amortised cost		4,272	5,134
Derivative financial assets	16	1,751	1,663
- of which: Held-for-trading derivative financial assets		1,642	1,663
Derivative financial assets held, from an economic point of view, for hedging purposes		108	0
Loans and advances to customers	17	167,048	143,814
- of which: Customer loans held for trading		5,060	0
Customer receivables measured obligatorily at fair value through profit or loss, not for trading		1,606	121
Customer loans designated as measured at fair value through profit or loss		17,540	9,938
Customer loans measured at amortised cost		142,842	133,755
Other assets	24	1,335	960
Intangible assets	25	796	642
Tangible assets	26	668	152
Deferred tax receivables	27	144	216
TOTAL ASSETS		**398,037**	**353,466**
Liabilities			
Liabilities to the MNB	19	28,350	22,628
Liabilities to credit institutions	19	48,072	15,024
- of this: financial liabilities designated as measured at fair value through profit or loss		72	102
Financial liabilities measured at amortised cost		48,000	14,922
Liabilities to customers	20	298,813	295,134
Derivative financial liabilities	16	1,115	1,263
- of which: Held-for-trading derivative financial liabilities		374	272
Derivative financial liabilities held, from an economic point of view, for hedging purposes		741	991
Issued bonds	21	5,252	5,283
Income tax payment liability		26	6
Deferred tax liability	27	0	0
Provisions	28	25	26

Item	Notes	31.12.2019	31.12.2018
Other liabilities	29	1,845	809
TOTAL LIABILITIES		**383,498**	**340,173**
Equity			
Subscribed capital	30	8,494	8,494
Capital reserve		4,477	4,477
Treasury stock		-1,344	-1,344
Profit reserve		1,065	51
Revaluation reserves (IFRS transition)		0	0
Reserve for share-based payment transactions settled in equity instruments		139	92
Other reserves		397	280
Cumulative other comprehensive income (OCI)		-33	-101
Non-controlling interests		1,344	1,344
TOTAL EQUITY	**38**	14,539	13,293
Liabilities and equity		**398,037**	**353,466**

On 22.04.2020 the Board of Directors approved the consolidated financial statements.

Éva Hegedűs — Chairman & CEO

Jenő Siklós — Deputy CEO

CHANGE IN CONSOLIDATED EQUITY
Data in HUF millions

	Subscribed capital	Capital reserve	Treasury stock	Cumulative other comprehensive income	Profit reserve	Miscellaneous reserves	Reserve for share-based payment transactions settled in equity instruments	Share of non-controlling owners	Total
Balance at start of period – 01.01.2019	**8,494**	**4,477**	**-1,344**	**-101**	**51**	**280**	**92**	**1,344**	**13,293**
other transfer	0	0	0	-13	13	0	0	0	0
Profit after tax	0	0	0	0	1,118	0	0	0	1,118
Other comprehensive income	0	0	0	81	0	0	0	0	81
Total comprehensive income	0	0	0	68	1,131	0	0	0	1,199
Transactions with owners	0	0	0	0	0	0	0	0	0
Employee Stock Ownership Plan	0	0	0	0	0	0	47	0	47
Transfer of general reserve	0	0	0	0	-117	117	0	0	0
Balance at end of period – 31.12.2019	**8,494**	**4,477**	**-1,344**	**-33**	**1,065**	**397**	**139**	**1,344**	**14,539**

	Subscribed capital	Capital reserve	Treasury stock	Cumulative other comprehensive income	Profit reserve	Miscellaneous reserves	Reserve for share-based payment transactions settled in equity instruments	Share of non-controlling owners	Total
Balance at end of period – 01.01.2018	**8,494**	**4,477**	**-1,344**	**95**	**-885**	**176**	**46**	**1,344**	**12,403**
Profit after tax	0	0	0	0	1,040	0	0	0	1,040
Other comprehensive income	0	0	0	-196	0	0	0	0	-196
Total comprehensive income	0	0	0	-196	1,040	0	0	0	844
Issue of ordinary shares	0	0	0	0	0	0		0	0
Employee Stock Ownership Plan	0	0	0	0	0	0	46	0	46
Transfer of general reserve	0	0	0	0	-104	104	0	0	0
Balance at end of period – 31.12.2018	**8,494**	**4,477**	**-1,344**	**-101**	**51**	**280**	**92**	**1,344**	**13,293**

On xx.04.2020 the Board of Directors approved the consolidated financial statements.

Éva Hegedűs
Chairman & CEO

Jenő Siklós
Deputy CEO

CONSOLIDATED CASH FLOW STATEMENT

Data in HUF millions

	2019	2018
Profit before tax	**1,376**	**1,240**
Modifying items		
Interest income	-6,183	-5,626
Interest expense	3,079	2,992
Impairment of tangible assets, and intangible assets	-303	-139
Net realised profit on the sale of tangible assets	1	-1
Impairment on debt securities, loans and other assets not measured through profit or loss	22	-64
Change in provisions	1	-11
Non-realised profit from financial instruments measured at fair value through profit or loss	580	-1,251
Deferred tax	-63	-11
Change in ESOP benefit plan reserve	46	46
	0	0
Change in the revaluation difference of financial instruments measured at fair value through other comprehensive income	79	-196
Cash flow from pre-tax operating income before change in operating assets and liabilities	**-1,365**	**-3,021**
Change in held-for-trading debt securities	-20,820	12,923
Change in debt securities designated as measured at fair value through profit or loss	10,291	2,978
Change in receivables from the MNB and other credit institutions	-9,148	-23,019
Change in loans and advances to customers	-24,402	-44,216
Change in other assets	191	138
Change in operating assets	**-43,888**	**-51,196**
Change in liabilities to the MNB and credit institutions	38,769	-98
Change in liabilities to customers	3,675	54,254
Change in other liabilities	1,070	-170
Change in operating liabilities	**43,514**	**53,986**
Change in derivative transactions	-316	-2,560
Interest received	4,823	5,981
Interest paid	-3,149	-3,137
Income tax paid	-195	-189
Net cash flow from operating activities	**789**	**2,885**
Purchase of debt securities measured at fair value through other comprehensive income	-21,143	-7,532
Purchase of equity securities measured at fair value through other comprehensive income	0	0

	2019	2018
Income from the sale or maturity of debt securities measured at fair value through other comprehensive income	21,761	6,768
Income from the sale or principal repayment of debt securities held at amortised cost	861	1,487
Purchase of tangible assets	-705	-31
Sale of tangible assets	6	5
Acquisition of intangible assets	-278	-134
Income from the sale of intangible assets	4	21
Dividend received	1	0
Investments in subsidiaries	0	0
Net cash flow from investment activities	**507**	**584**
Net cash flow from financing activities		
Issue of shares	0	0
Non-share capital contribution by shareholders	0	0
Repayment of supplementary payment	0	-1,608
Income from bond issue	0	0
Net cash flow from financing activities	**0**	**-1,608**
Currency revaluation difference of liquid assets	0	0
Net increase/decrease in liquid assets	**-69**	**-1,160**
Liquid assets at the beginning of the year	8,915	10,075
Liquid assets at the end of the year	8,846	8,915

Liquid assets components	**2019**	**2018**
Cash	569	421
Account receivables from central banks	2,342	2,701
Other demand deposits	5,935	5,793
Total	**8,846**	**8,915**

DETAILS OF CONSOLIDATED CASH FLOW FROM FINANCING ACTIVITIES

	Subscribed capital	Capital reserve	Issued bond	Supplementary payment
Liabilities related to financing activities 01.01.2018	**8,494**	**4,477**	**5,250**	**1,608**
Capital raise	0	0	0	0
Bond issue	0	0	0	0
Repayment of supplementary payment	0	0	0	-1,608
Liabilities related to financing activities 31.12.2018	**8,494**	**4,477**	**5,250**	**0**
Capital raise	0	0	0	0
Bond issue	0	0	0	0
Repayment of supplementary payment	0	0	0	0
Liabilities related to financing activities 31.12.2019	**8,494**	**4,477**	**5,250**	**0**

On 22.04.2020 the Board of Directors approved the consolidated financial statements.

Éva Hegedűs — Chairman & CEO

Jenő Siklós — Deputy CEO

1. GENERAL INFORMATION

Date of establishment

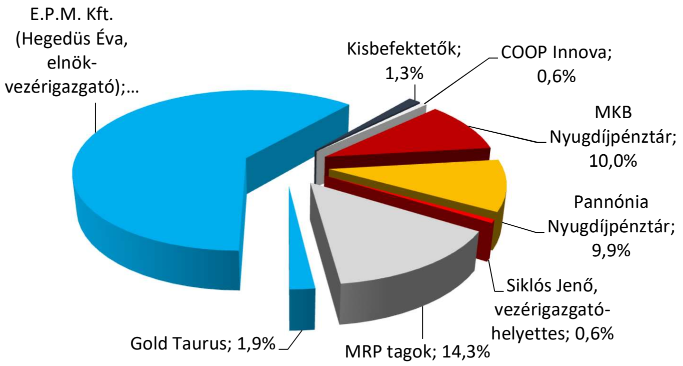
GRÁNIT BANK ("Bank") is a commercial bank operating as a private limited company incorporated in Hungary, established on 25 September 1985 under the name Általános Vállalkozási Bank Rt.
Following several changes of ownership, as the legal successor of the previous banks, the Bank has, since 20 May 2010, been trading under the name GRÁNIT Bank Zrt.
The company's registered office: 1095 Budapest, Lechner Ödön fasor 8.
Company court registration number: 01-10-041028
Website: www.granitbank.hu

Range of activities

The Bank is entitled to offer financial and supplementary financial services as listed in Section 3 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises.
The National Bank of Hungary issued a foreign-exchange authority licence to the Bank on 20 July 1994, in which it authorised the Bank to provide financial services in foreign currency.
Since 17 April 2000, based on resolution 41031-4/1999 of the Hungarian Financial Supervisory Authority (MNB), the Bank has been engaged in universal banking activities.

Ownership structure

GRÁNIT Bank's ownership structure



*ESOP – GRÁNIT Bank ESOP Entity

Shareholders with majority influence in the Bank Group

E.P.M Kft. (Ultimate controlling party: Éva Hegedűs, Chairperson & CEO), voting rate: 61.2%
Seat: 1034 Budapest, Testvérhegyi út 56-58.

Companies included in the consolidated financial statements as subsidiaries

GRÁNIT Bank ESOP Entity
GB Solutions Zrt.

Persons authorised to sign the consolidated annual financial statements of the Bank Group

Éva Hegedüs (Chairwoman & CEO)
1037 Budapest, Testvérhegyi út 56-58.
Jenő Siklós (Deputy CEO)
2481 Velence, Muskotály u. 1.

Members of the Bank's Board of Directors and Supervisory Board

Board of Directors	**Supervisory Board**
Éva Hegedüs (Chairwoman & CEO)	Sándor Nyúl (Chairman)
Jenő Siklós (Deputy CEO)	János Vokony
Zoltán Nagy (Deputy CEO)	Gyuláné Lajtos
László Hankiss (Deputy CEO)	
Gergely Domonkos Horváth	

2. ACCOUNTING POLICY

Name of person responsible for compiling the IFRS statements: Jenő Siklós (registration number: 133130),

2.1. Basis for preparing the statements

The Bank's financial statements were prepared on a cost value basis, except for the following essential elements:

Items	Basis for measurement
Financial instruments measured at fair value through profit or loss	Fair value
Financial assets measured at fair value through other comprehensive income	Fair value

The Bank keeps its accounting records and compiles its ledger in accordance with the provisions of commercial banking and financial legislation in force in Hungary. The Bank's books are kept in Hungarian forint ("HUF"). Unless otherwise stated, balances are shown in million forints ("million HUF").

Declaration of conformity

As from 1 January 2018, the Bank uses IFRSs for statutory purposes instead of the Hungarian accounting standards (the date of transition is therefore 1 January 2017).
This financial statement has been prepared in accordance with International Financial Reporting Standards (IFRS) and all rules thereunder as applicable and adopted by the EU.
Besides this financial statement, the Bank prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) and all rules thereunder as applicable and adopted by the EU.
The Bank's stand-alone and consolidated statements are approved and published on the same day.

2.2. Estimates

In some cases, the management needs to make significant estimates or assumptions when preparing the financial statements under IFRS. These significant estimates and assumptions affect the value of assets and liabilities, and of income and expense, shown in the financial statements, as well as the presentation of contingent assets and liabilities presented in the Notes to the accounts. Actual results may differ from estimated data.

Estimates and related assumptions are based on past experience and other factors considered relevant. Accounting estimates and the underlying assumptions are reviewed by the Bank on an annual basis. Changes to accounting estimates are recognised by the Bank during the period of the respective change.

The Bank discloses the nature and amount of changes in accounting estimates that have an impact on the current period or are expected to have an impact on future periods, except for the effect on future periods in cases when making an advance estimate is impossible. If the amount of an impact on future periods is not disclosed because an estimate cannot be made, the Bank must disclose this fact.

Future changes in the economic environment, financial strategy, regulatory environment, accounting regulations, and other areas may result in changes in estimates that may have a significant impact on future financial statements.

The most important estimates and assumptions that have an impact on the Bank's report:

- Classification of financial assets: assessment of the exclusive principal and interest requirement pertaining to the characteristics of the business model and the contractual cash flows (see Section 2.7.1 for details)
- Impairment on financial assets (see Sections 2.7.3 and 38.6.1 for details)

- Determination of the fair value of financial instruments in cases where the fair value of a financial instrument is determined by the Bank on the basis of significant unobservable inputs (see Note 24 for more details).
- Determination of the fair value of derivative transactions in cases where the fair value of a financial instrument is determined by the Bank on the basis of significant non-market inputs (see Note 6 for more details).
- Determination of deferred tax receivables: assessment with respect to the attainment of future taxable profit (see Section 2.6.15 for details).
- Provisioning: estimation of the likelihood or extent of liabilities arising from a past event (see Section 2.6.11 for details).

2.3. Currency translation

The functional currency of the Bank is Hungarian forint (HUF). **The Bank presents its financial statements in Hungarian forints rounded to the nearest million.**

The Bank records its foreign currency held on account and in cash, as well as its receivables and liabilities in foreign currencies, at the time of acquisition or generation, in the respective currency, and also records them in forint at the MNB's prevailing mid foreign exchange rate.

The Bank revalues its foreign currency held on account and in cash, as well as its receivables and liabilities denominated in foreign currencies, once a month, at the MNB's prevailing mid foreign exchange rate.

The Bank recognises the profit from revaluation in its end-of-month and end-of-year financial statements in the Profit or loss from FX transactions line, except for the foreign currency exchange rate difference related to financial instruments measured at fair value through profit or loss, which is recorded in the Profit or loss from changes in fair value of financial instruments line.

Realised exchange rate differences arise when the transactions are settled, if the rates at acquisition and settlement differ. The resulting exchange rate gain or loss is usually recognised in profit after tax. Exceptions are investments in proprietary equity instruments for which, at the time of initial recognition, the Bank has made an irrevocable decision to measure them at fair value through other comprehensive income (FVOCI), in the case of which the exchange rate difference is recognised in other comprehensive income.

In the case of financial assets measured at fair value through other comprehensive income (FVOCI), the Bank recognises the exchange rate difference against their amortised cost through profit or loss, in the Profit from FX transactions line, and other changes in book value are recognised through other comprehensive income.

2.4. Subsequent events

Events occurring after the end of the reporting period that provide additional information on circumstances existing at the end of the Bank's reporting period (Modifying items) are presented in the financial statements. Events after the reporting period that do not affect the data of the financial statements are presented in the Notes to the accounts if they are material.

If the Bank determines the dividend payable to its owners after the balance sheet date; this dividend is not presented as a liability at the balance sheet date. Such dividend is disclosed by the Bank in the Notes to the accounts if it has been determined after the balance sheet date but before the financial statements are approved for publication.

2.5. Income Statement

2.5.1. Interests

Effective interest rate

The Bank determines interest income and interest expense using the effective interest method and recognises them in profit or loss. The effective interest rate is the rate at which the estimated future cash flows over the term of the financial asset or financial liability can be discounted:

- in the case of financial assets, to the gross book value,
- in the case of financial liabilities, to the amortised cost.

When the Bank determines the effective interest rate for (non-impaired) financial instruments, it estimates future cash flows by taking into account all contractual conditions of the financial instrument (prepayment, prolongation of term, callback, or similar options), but disregarding any expected credit losses.

In the case of purchased or originated credit-impaired financial assets (i.e. financial assets that are already impaired at the time of initial recognition) the Bank determines the interest income by applying the *credit-adjusted effective interest rate* method. The credit-adjusted effective interest rate is the rate by which the estimated future cash payments or cash incomes over the life of the financial asset may be discounted precisely down to the amortised cost of the purchased or originated credit-impaired financial asset. When calculating the credit-adjusted effective interest rate, the Bank estimates the expected cash flows taking into account all contractual terms applicable to the financial asset and the expected credit loss.

The effective or credit-adjusted effective interest rate includes all fees and items paid or received by the contractual parties that are an integral part of the effective interest rate, as well as transaction costs and any other premium or discount. Transaction costs are ancillary costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

Determining interest income and interest expense

The Bank determines interest income or interest expense based on the gross book value in the case of (non-impaired) financial assets and amortised cost in the case of financial liabilities, using the effective interest rate.

For financial assets that became impaired after initial recognition, the Bank applies the effective interest rate to the amortised cost in the subsequent reporting periods, using the principle of gross settlement. Therefore in this case the effective interest rate is determined separately for the gross value and separately for the impaired amount and is also separately recorded in the balance sheet for the gross value and the impairment of the financial asset. If, during a subsequent period, as a result of a significant improvement in credit risk, the financial asset no longer qualifies as an impaired financial asset, the Bank determines the interest income by applying the effective interest rate to the gross book value. In the case of purchased or generated financial assets that were impaired at initial recognition, the Bank applies the credit-adjusted effective interest rate to the amortised cost from the initial recognition of the financial asset to determine the interest income.

Recognition of interest income and interest expense

In the statement of income, interest income and interest expense related to the following financial instruments are presented under *Interest income* and *Interest expense*:
- interest on financial assets and financial liabilities measured at amortised cost, that is determined using the effective interest method;
- interest on interest-bearing financial instruments measured at fair value through profit or loss, that is determined using the effective interest method;
- interest on debt securities measured at fair value through other comprehensive income, that is determined using the effective interest method;

- other income similar to interest not determined using the effective interest method (typically, interest income on derivative financial instruments)

2.5.2. Fees and commissions

Fees and commissions that are part of the effective interest rate are recognised in the income statement under *Interest income* or *Interest expense*. All other fee and commission income is recognised in the income statement under *Fee and commission income*.

Recognised fees that are not an integral part of the effective interest rate of a financial instrument include:

- fees charged for credit services;
- commitment fees for the origination of a loan for which the loan commitment is not measured at fair value through profit or loss and it is unlikely that a special loan agreement will be concluded;
- credit syndication fees received by the Bank that arise where the Bank intermediates a loan and keeps nothing from the loan package for itself (or keeps a part of the package at the same effective interest rate and at similar risk as other participants).

Fees and commission expenses not included in the effective interest rate are usually service fees that are recognised by the Bank as an expense when it receives the service.

2.5.3. Net profit from financial instruments measured at fair value through profit or loss

In this line, the Bank recognises its net profit from held-for-trading financial instruments, financial instruments measured obligatorily at fair value through profit or loss, not for trading, as well as from financial securities designated as measured at fair value through profit or loss, except for the profit from the interest on those instruments, which is shown under the Interest income / (interest expense) line.

2.5.4. Net profit from financial instruments not classified as measured at fair value through profit or loss

In this line the Bank recognises the net profit realised on the sale of securities measured at amortised cost and at fair value through other comprehensive income.

Impairment losses and other profits realised on customer loans measured at amortised cost are recognised under Credit loss and profit. It is also here that impairment recorded on securities held at amortised cost and on debt securities measured at fair value through other comprehensive income is recognised.

2.5.5. Net profit from hedge accounting

The Bank does not currently use hedge accounting in its statements.

2.5.6. Profit from FX transactions

Under Profit from FX transactions are recognised the realised exchange rate gains on financial instruments held in non-functional currencies as well as the unrealised gains on exchange rate changes in respect of financial assets and liabilities not measured at fair value through profit or loss.

2.5.7. Dividend income

The Bank only recognises dividends in profit or loss when its right to the dividends has been established, it is likely that the economic benefits associated with the dividend will be realised as income and the amount of the dividend can be measured reliably.

2.5.8. Other operating income

Under other income the Bank recognises

- the net result from the sale of non-financial assets, if it is net income
- other income related to non-financial assets and liabilities

2.5.9. Other expenses

Under other expenses the Bank recognises

- the net result from the sale of non-financial assets, if it is a net loss
- Non-income tax expenses, except for taxes on personnel expenses, which are recognised under personnel expenses.
- Recognised impairment on non-financial assets
- other expenses related to non-financial assets and liabilities

2.5.10. Credit loss and profit

Under this line the Bank recognises the following items:

- Impairment on financial assets (see the description of impairment in Section 2.6.3)
- Net profit from the sale of loans and advances to customers
- Income and expenses related to other lending activities (write-downs, recoveries from write-downs, items related to recovery, etc.)

2.5.11. Personnel expenses

Under Personnel expenses are recognised

- wage costs, which are the gross earnings (wages) due to employees
- other payments to personnel, including all payments related to the calendar year that the Bank recognises or pays to a private individual in accordance with other regulations under a heading other than wage costs, excluding considerations paid for contractor activities.
- wage contributions, namely pension insurance and health insurance contributions, health contributions, employers' contributions, vocational training contributions, and all other taxes and contributions that are based on payments related to personnel or the number of employees.

2.5.12. Other general administrative costs

Under Other administrative costs the Bank recognises material expenses (the value of the use of purchased materials, fuel costs and impairment on inventories) and other administrative costs (telecommunication and postal charges, IT operating costs, rents paid, costs of services used, costs of other services), as well as transaction tax and special bank tax.

2.5.13. Depreciation

On intangible assets and tangible assets, the Bank recognised depreciation up to the gross cost of the intangible assets and tangible assets. The Bank depreciates tangible assets below an individual purchase or production value of HUF 100,000 immediately, at the time of the purchase. Depreciation recognised in the financial year is shown as a separate cost item in the income statement as part of the net operating profit.

2.5.14. State subsidies

State subsidies are state contributions in which resources are transferred to the Bank and which are provided by the State against past or future fulfilment of specific conditions related to the Bank's operational activities.

The Bank recognises state subsidies when it becomes probable that the subsidy will be realised and the conditions related to the disbursement of the subsidy are met. When the subsidy is used to offset a cost, the Bank recognises the subsidy in profit or loss in the period in which the cost to be offset arises.

The Bank recognises state subsidies related to asset purchases as deferred income and releases and recognises this deferred income in the profit or loss, in equal annual amounts, over the useful life of the related asset.

Interest subsidy on loans with state interest subsidy are not considered to be state subsidies under IAS 20, since in these cases the beneficiary of the interest subsidy is the customer, and the Bank plays only an intermediary role.

In the case of non-market transactions concluded with the MNB, the Bank decides individually whether the special conditions of the given transaction constitute a state subsidy.

2.5.15. Income taxes

Recognised profits or losses from actual and deferred corporate tax are recognised under Income taxes.

Actual and deferred tax is recognised as income or expense and is included in the after-tax profit or loss for the period, except when the tax is incurred in the settlement of transactions or events – in the same or another period – that the Bank recognises through other comprehensive income or directly in equity.

Actual tax

Actual tax on profits includes corporate income tax, local tax and innovation contribution. The corporate tax is paid to the national tax authorities competent with respect to the Bank's place of business. The basis for tax payment is the pre-tax profit calculated from the tax-paying company's accounting profit adjusted by items reducing and increasing the tax base. The local tax and the innovation contribution are paid to the relevant local authority, and the tax is based on the Bank's annual net turnover determined by law.

Actual taxes relating to the current period and prior periods that are still not settled are recognised as liabilities by the Bank. If the amount already paid for the current period and prior periods exceeds the amounts due for these periods, the excess is recognised as an asset.

Actual tax liabilities (tax receivables) for the current period and prior periods are valued at the amount that is expected to be paid to the tax authority (or expected to be recovered from the tax authority), using tax rates (and tax laws) that were in force or substantially in force by the date on which the statement of financial position is based.

Deferred tax

The corporate income tax is determined by the Bank in accordance with the regulations of the Hungarian tax laws. Deferred taxes are calculated using the balance sheet liability method:

- temporary differences are determined in the difference between the value of assets and liabilities shown in the accounting report and the amounts recognised for corporate tax purposes; and
- deferred tax is calculated on the basis of the temporary difference.

Under the liability method, deferred tax is recognised at the balance sheet date for the temporary differences between the tax base of assets and liabilities and their carrying amount recognised for reporting purposes. The method of accounting for deferred taxes on a balance sheet basis is based on the exploration of cumulative differences. Accordingly, the Bank prepares its tax and accounting balance sheet and examines the difference between the two from the point of view of deferred tax.

The key to calculating deferred taxes is to offset the tax effect of temporary income and tax differences. Accordingly, the deferred tax is calculated for the differences between tax law and IFRS statements.

The amount of the deferred tax is calculated by the Bank using tax rates stipulated by the relevant tax law, as known at the balance sheet date, which are expected to be effective at the time when the deferred tax receivable will be collected or the deferred tax liability settled.

Any deferred tax receivables are recognised to the extent that it is probable that future taxable profits (or reversible deferred tax liabilities) will be available against which the deferred tax receivable can be offset.

The Bank examines the value of the deferred tax receivable at each balance sheet date and reduces it to the extent that it is unlikely that sufficient taxable profit will be generated for it to be enforced partially or fully. The Bank reverses any such reduction to the extent that it becomes probable that sufficient taxable profit will be available.

The Bank offsets its deferred tax receivables and deferred tax liabilities against each other when and only if:

- it has a legally enforceable right to offset its actual tax receivables against its actual tax liabilities; and
- the deferred tax receivables and deferred tax liabilities are related to income taxes imposed by the same tax authority.

2.6. Balance sheet items

2.6.1. Financial instruments

The Bank recognises financial instruments in accordance with IFRS 9.

Financial assets include liquid assets, government securities, receivables from credit institutions, loans and advances to customers, debt securities, shares, participations, and derivative transactions. Financial assets are recognised by the Bank in the following balance sheet lines:

(a) Liquid assets and equivalent
(b) Receivables from the MNB
(c) Interbank placements
(d) Securities
(e) Derivative financial assets
(f) Loans and advances to customers
(g) Other assets (buyers)

Financial liabilities arise from claims for the repayment of money or other financial assets. They mostly include liabilities to credit institutions, liabilities to customers, suppliers, and derivative financial liabilities. Financial liabilities are recognised by the Bank in the following balance sheet lines:

(a) Liabilities to the MNB
(b) Liabilities to credit institutions
(c) Liabilities to customers
(d) Derivative financial liabilities
(e) Other liabilities (trade creditors)

Recognition and initial measurement

The Bank recognises loans and receivables, deposits, and debt securities when they arise. All other instruments are recognised on the day the Bank commits to purchase or sell the asset.

With the exception of trade receivables, the Bank recognises all financial assets not measured at fair value at their fair value adjusted by the transaction costs that are directly related to their issue or purchase.

Financial assets measured at fair value are recognised at fair value, and the transaction costs directly related to their issue and purchase are recognised through profit or loss.

With the exception of financial liabilities measured at fair value through profit or loss, the Bank recognises financial liabilities at fair value adjusted by transaction costs. In the case of financial liabilities measured at fair value through profit or loss, the value at initial recognition is the fair value; directly related transaction costs are recognised through profit or loss.

Transaction costs include fees and commissions paid to agents, advisers, brokers, and traders, as well as fees charged by regulators and stock exchanges, and taxes and fees related to the transfer. Transaction costs exclude premiums and discounts arising from lending, financing costs, internal administrative or holding costs.

Trade receivables, if they do not contain a material financing component, are recognised by the Bank at transaction price.

Trading-day and settlement-day accounting

All financial assets purchased or sold "in a standard way" are recognised on the settlement date, i.e. when the asset is transferred to the counterparty. Standard purchases or sales include transactions where the asset is to be transferred within a period specified by regulations or market practices.

First-day profit or loss

The best approximation of the initial fair value of financial instruments is the transaction price.
Gains or losses can arise at initial recognition only if there is a difference between the fair value and the transaction price, as supported by measurement techniques based on other observable market transactions of the same instrument or some observable market data. In the case of other financial instruments where fair value is based on measurement techniques using Level 3 parameters, the initial difference is recognised as (other) assets or (other) liabilities and subsequently a steady-rate amortisation is applied to it until the maturity of the instrument.

Classification
Classification of financial assets

The Bank classifies its financial assets in the following categories:

a) financial assets measured at fair value through profit or loss;
b) financial assets measured at amortised cost;
c) debt instruments measured at fair value through other comprehensive income; and
d) investments in equity instruments measured at fair value through other comprehensive income.

The Bank measures the financial asset at amortised cost if both of the following conditions are met:

- the financial asset belongs to a group in which the business model is the collection of contractual cash flows; and
- the contractual cash flows of the financial asset only include principal and interest on the outstanding principal.

The amortised cost of financial assets or financial liabilities is the value of the financial asset or financial liability as determined at initial recognition less principal repayments, increased or decreased by the accumulated amortisation of the difference between this original value and the value at maturity using the effective interest rate method, and, in the case of financial assets, decreased by accumulated impairment.

The gross book value of financial assets is the amortised cost of the asset before impairment.

The Bank measures the financial asset as a financial asset measured at fair value through other comprehensive income if both of the following conditions are met:

- the financial asset belongs to a group in which the business model is the collection of contractual cash flows and sale; and
- the contractual cash flows of the financial asset only include principal and interest on the outstanding principal.

Investments in equity instruments are measured by the Bank at fair value, unless the Bank, at the time of initial recognition, makes an irrevocable decision to choose the "measured at fair value through other comprehensive income" category for the financial asset in question.

All other financial assets are categorised by the Bank in the measured at fair value through profit or loss category.

At initial recognition, the Bank has the option to classify a financial instrument measured at amortised cost or measured at fair value through other comprehensive income as irrevocably classified in the measured at fair value through profit or loss category if this eliminates or significantly reduces an accounting inconsistency.

The decision-making person or body determines the classification of financial instruments at the time of purchase.

Classification of financial liabilities

The Bank classifies its financial liabilities in the following categories:

- financial liabilities measured at fair value through profit or loss,
- financial liabilities measured at amortised cost

Non-trading financial liabilities are measured by the Bank at fair value at initial recognition, less directly attributable transaction costs; any subsequent measurement is at amortised cost using the effective interest method, unless the Bank at initial recognition designated the financial liability as measured at fair value through profit or loss.

If the Bank designated a financial liability as measured at fair value through profit or loss at initial recognition, in any subsequent measurements

- the changes in fair value, if related to the Bank's own credit risk, are recognised through other comprehensive income,
- all other changes of fair value are recognised through profit or loss.

During the initial recognition of a financial liability designated as measured at fair value through profit or loss, the Bank examines whether the recognition of fair value changes related to its own credit risk in other comprehensive income triggers (or increases) any accounting inconsistencies. If the measurement against other comprehensive income causes or deepens accounting imbalances, the Bank fully records the change in fair value through profit or loss.

The Bank uses the contractual conditions of the issued instrument as a basis for classifying the instrument as a financial liability or equity.

Specification of business model

The Bank specifies the purpose of its business model relating to its portfolio of assets. To do this, it takes the following information into consideration:

- principles and objectives attached to the portfolio and the practical applications of these principles. The management's portfolio-related strategy may focus on collecting contractual interest income, maintaining a given interest rate level, adjusting the maturity of financial assets to the maturity of the financial liabilities that finance them, or realising cash flows through the sale of the asset;
- how the portfolio's performance is evaluated and reported to management;
- the risks affecting the performance of the business model (and the financial assets included in it), and the manner in which these risks are managed;
- the method of remuneration of the managers of the Bank: whether it depends on the development of the fair value of the managed assets or the collection of contractual cash flows; and
- the frequency, extent and timing of sales of previous periods, the reason for sales, the expectations for future sales. When evaluating information about past sales, it takes into account the reasons for sales, the conditions prevailing at the time of the sales, and compares them with current conditions. The Bank does not evaluate the information on sales in an isolated manner but collectively, i.e. it looks at how the objective formulated by the Bank is achieved and how the cash flows related to the financial instrument are realised.

Based on the above, the Bank classifies its financial assets according to three business models:

- "Collection of contractual cash flows" includes the financial assets for which the key business objective is the collection of contractual cash flows;
- "Collection of contractual cash flows and sale" includes the financial assets for which the business objective is partly achieved by collecting the contractual cash flows of the financial assets and partly by selling the financial assets; and
- "Other" includes the financial assets that do not belong to the groups under the other two business models.

The financial assets held by the Bank for trading purposes, or the performance of which is measured at fair value, are measured at fair value through profit or loss, as in the case of these the objective is neither the collection of contractual cash flows nor the collection of contractual cash flows and the sale of the assets.

Measurement of the characteristics of contractual cash flows

Classification in a measurement group also depends on the characteristics of the cash flows associated with the financial asset. For financial assets that the Bank intends to measure at amortised cost or at fair value through other comprehensive income, the Bank must consider whether they in terms of the cash flows of the financial asset meet the solely principal and interest (SPPI) requirement under IFRS 9. The principal is the fair value of the financial asset at initial recognition. Interest primarily expresses the consideration for the time value of the outstanding amount of principal and the credit risk in a given period, but it also includes other basic credit risks and costs, as well as a profit margin.

If the SPPI requirement is met, the Bank examines, in the denominated currency of the financial asset, whether the cash flows arising from the contract are consistent with the basic loan agreements.

To assess whether the contractual cash flows only include principal and interest payments, the Bank examines the contractual terms of the financial instrument. The examination also includes the assessment of whether the financial asset contains any contractual conditions that result in a change in the amount or timing of contractual cash flows that makes the financial asset no longer meet the SPPI requirement. To assess this, the Bank takes into account:

- future events, the occurrence of which affects the amount and timing of contractual cash flows;
- leverage characteristics;

- conditions for prepayment and term extension;
- conditions that put a limit on the Bank's claims related the given asset's cash flows (e.g. non-recourse asset agreements); and
- the existence of a modified element related to the time value of money.

Contractual cash flows do not solely include principal and interest, if in the contractual cash flows there are risks or volatility exposures not associated with a basic loan agreement. Thus a financial instrument fails to meet SPPI requirements if the contractual cash flows include exposure to changes in share prices or commodity prices, or if they include leverage.

If the element related to the time value of money is imperfect – for example, the frequency of the repeated establishment of the interest rate does not correspond to the interest rate period, or if the interest rate of the financial instrument is adjusted to the average of short- and long-term interest rates on a regular basis –, the Bank must assess the change individually to establish whether the contractual cash flows solely include principal and interest. Depending on the given situation, this is determined by a qualitative assessment of the time value element and, if necessary, by a quantitative assessment. If the Bank arrives to the conclusion that the undiscounted cash flows arising from the contract are significantly different from the undiscounted reference cash flows, the financial asset must not be measured at amortised cost or at fair value through other comprehensive income.

In the case of state-regulated interest rates, the financial asset meets the SPPI requirement if the regulated interest rate represents a consideration that basically is in harmony with the passing of time and does not represent a risk or volatility exposure regarding the cash flows that are inconsistent with a basic loan agreement.

The Bank has such loans to customers (NHP) in respect of which the interest rate has an upper cap. When examining the contractual cash flows of these financial assets, the Bank has determined that they include only principal and interest, and therefore their subsequent valuation is measured at amortised cost.

Reclassification of financial instruments

After initial recognition, the Bank will not reclassify its financial instruments in another measurement category with the exception of the rare cases when the business model underlying the financial assets has changed. In such cases, the Bank performs reclassification on the first day of the next reporting period and explains the reason and effect of the classification in the Notes to the financial statements.

Derecognition
Derecognition of financial instruments

The Bank derecognises a financial asset if
- the contractual right to the cash flows from the financial asset expires; or
- the contractual rights are transferred in a manner by which substantially all risks and rewards associated with the financial asset are transferred; or
- the Bank does not transfer and neither does it retain substantially all risks and gains associated with the financial asset, but does not retain control over the financial asset.

When a financial asset is derecognised, the difference between the book value of the asset (or the book value associated with the derecognised part of the asset) and the consideration received for the derecognised asset (or part of the asset) (including any new asset received, less any liability assumed) is recognised in profit or loss.

The cumulative other comprehensive income recognised for a derecognised asset (or part of an asset) must be reclassified to profit or loss upon derecognition, except for investments in equity instruments measured at fair value through other comprehensive income: in their case, the cumulative other comprehensive income is transferred directly to Profit reserve upon derecognition, without affecting profit or loss.

Any remaining or generated interest related to the derecognised asset is recognised by the Bank as an independent asset.

If the Bank transfers a financial asset in such a way that it retains substantially all risks and gains associated with the transferred asset (part of an asset), the Bank must not derecognise the financial asset from its balance sheet. On this basis, the Bank will not derecognise from its books any securities lent or financial assets sold with a repurchase agreement for which it has retained substantially all risks and gains.

Should the Bank transfer an asset without either transferring or retaining substantially all risks and gains associated with the financial asset, but retaining the control of the asset, the Bank will continue to recognise the financial asset to the extent of its continuing interest in the asset transferred. The extent of continuing interest is the extent to which the Bank is exposed to the risks of changes in the value of the asset transferred.

If the Bank derecognises a financial asset and retains the right to manage the financial asset for a fee, it will recognise a management instrument or a management liability in relation to the management contract in question. If the stipulated fee is not expected to cover the management duties to be performed, the Bank will recognise a management obligation with respect to the commitment. If the stipulated fee is expected to exceed the value of the management activities, the Bank will recognise a management asset with respect to the management right.

Derecognition of financial instruments

The Bank derecognises a financial liability when it is terminated, i.e. when the commitments specified in the given contract have been fulfilled, they have been cancelled, or they have expired.

Change in the conditions of financial assets and financial liabilities
Change in the conditions of financial assets

If the conditions of a financial asset are changed, the Bank will examine whether the cash flows related to the modified financial asset are significantly different. If the cash flows are significantly different, the contractual cash flows associated with the original financial asset are considered to have expired: the original financial asset must be derecognised and the new financial asset must be recognised at fair value.
If the cash flows of a modified financial asset measured at amortised cost do not show any significant differences, the Bank will not derecognise the financial asset. In such cases, the Bank recalculates, adjusts the gross book value of the financial asset and recognises the resulting difference in profit or loss. If the change is made on account of the debtor's financial difficulties, the profit effect of the change must be recognised together with the impairment loss. In all other cases, the effect on the profit or loss must be recognised as interest income.

Change in the conditions of financial liabilities

The Bank will derecognise a financial liability if the underlying contractual terms have changed and the cash flows of the changed liability show significant differences. In this case, the new liability is recognised by the Bank at fair value in accordance with the modified contractual terms, the old liability is derecognised and the difference is recognised in profit or loss.

Netting of financial assets and financial liabilities

Financial assets and financial liabilities are offset by the Bank against one another and the resulting net amount is recognised in the balance sheet when and only if the Bank has a legally enforceable right to offset the amounts and it intends to realise the asset and meet the liability by netting or concurrently.

Repo and reverse repo agreements

Assets that the Bank sells under an agreement for the subsequent repurchase of the asset (repo agreement) are not derecognised; their measurement is subject to accounting standards pertaining to financial assets. The repurchase obligation is recognised as a liability held at amortised cost in the statement of financial position at the amount of the proceeds from the sale. The difference between the sale price and the repurchase price must be treated as interest expense and recognised pro rata over the term of the transaction in profit or loss.
Assets that the Bank purchases under an agreement for the subsequent resale of the asset (reverse repo) are not included in the balance sheet because the Bank has no control of these assets. Receivables arising from such agreements can appear in the balance sheet in an amount identical to the purchase value under Loans and advances to customers. The difference between the purchase price and the future selling price must be treated as interest income and recognised pro rata over the term of the transaction in profit or loss.

2.6.2. Determining fair value

Fair value is the price that the Bank would receive upon the sale of an asset, or that it would pay upon transferring a liability, on the primary market, or in the absence of this, on an optimal market, under a standard transaction between market participants at the time of the measurement. The fair value of a liability reflects the effect of the risk of default. Besides measurement at the time of initial recognition, the Bank performs the measurement of fair value on a daily basis.

IFRS 13 "Fair value measurement" creates a fair value hierarchy in order to increase the consistency and comparability of measurements at fair value and related disclosures. The hierarchy categorises the inputs of measurement methods used to determine fair value into the following three levels:

- Level 1 inputs: Quoted (unadjusted) prices on active markets of identical assets or liabilities to which the Bank has access at the time of the measurement;
- Level 2 inputs: Inputs included in Level 1 other than quoted prices, that are directly or indirectly observable concerning the asset or liability; and
- Level 3 inputs: Non-observable inputs of the assets or liabilities.

If available, the Bank determines the fair value of the instrument based on the price quoted on an active market. A market is considered active if transactions relating to the asset or liability are carried out with sufficient frequency and quantity to enable the market to provide ongoing pricing information.

If no quoted prices from an active market are available, the Bank uses measurement techniques that are appropriate under the given circumstances and for which sufficient data are available to determine fair value. The use of relevant observable inputs must be maximised and the use of non-observable inputs must be minimised during the process. Measurement techniques are regularly reviewed by the Bank and each measurement technique is based on the latest market data. Measurement techniques are based on available market data, so their use must entail certain estimates and assumptions (correlations, volatilities, etc.). Changes in assumptions may affect the fair value of financial instruments presented.

The fair value of a financial asset at initial recognition is usually the transaction price. If the Bank determines that the transaction price differs from the fair value at initial recognition, it will do the following:

- if the financial asset has an active market or the fair value is based on a measurement technique that only uses data from observable markets, the Bank immediately recognises the difference between the fair value at initial recognition and the transaction price in profit or loss.
- in all other cases, the Bank defers or accrues the difference between the fair value at initial recognition and the transaction price. The accrued or deferred difference is recognised in profit or loss so as to be consistent with the change in the value of the financial asset.

In the case of NHP loans (both receivables and payables) the Bank accrues or defers the difference between the transaction price and the fair value at initial recognition, and recognises it in profit or loss over the term of the loan in accordance with the change in the value of the loan.

Transfers between various levels of the fair value hierarchy are recognised at the end of the reporting period in which the change occurred and the movements between hierarchy levels are presented in the Notes to the accounts.

The methodology used for the measurement of fair value, and the inputs and assumptions used for the calculations, are detailed in Note 23.

2.6.3. Impairment

Due to expected credit losses, the Bank recognises impairment in respect of the following financial instruments not measured at fair value through profit or loss:

(a) debt instruments,
(b) issued financial guarantees, and
(c) issued loan commitments.

The Bank recognises no impairment on investments in equity, as these are recognised at fair value in the balance sheet.

The Bank calculates the impairment for the remaining term, except for the following financial instruments, for which impairment is calculated for 12 months:

- debt securities with low credit risk at the reporting date,
- other financial instruments the credit risk of which has not deteriorated significantly compared to that at initial recognition.

The Bank considers debt securities to be low-risk if their credit rating qualifies as "investment grade".

Impairment calculated for a 12-month period for expected credit losses is the part of the expected losses for the entire term that results from default events that may occur within 12 months of the reporting date.

For purchased or originated credit-impaired (POCI) financial assets the Bank recognises as a loss at the reporting date only the cumulative changes that have occurred since initial recognition in the lifetime expected credit losses.

Determining the expected credit loss

Expected credit losses are the probability-weighted estimates of credit losses incurred over the expected life of the financial asset.

Expected loss on modified financial assets

If the conditions of a financial asset are renegotiated or changed, or an existing financial instrument is replaced with another because of the debtor's financial difficulties, it must be examined whether the financial instrument is to be derecognised. As a result, the Bank determines the expected credit loss for the existing financial asset as follows:

- if the expected change in the financial asset does not result in the derecognition of the existing financial asset, the Bank will take the expected cash flows associated with the changed financial asset into consideration when determining the lost cash flows related to the original financial asset.
- if the expected change in the financial asset results in the derecognition of the financial asset, the Bank will consider the expected fair value of the new financial asset to be the last cash flow related

to the existing financial asset at the date of derecognition. This value will be used to determine the cash flow losses associated with the existing financial asset by discounting the value at derecognition at the original effective interest rate of the financial asset to the value at the reporting date.

Impaired financial assets

At each reporting date, the Bank assesses whether its financial assets measured at amortised cost and debt instruments measured at fair value through other comprehensive income are impaired. A financial asset is considered impaired if one or more events have occurred that had an adverse effect on the expected future cash flows associated with the financial asset.

If the conditions of a loan are renegotiated due to the deterioration of the debtor's position, the loan must be considered impaired, unless it can be shown that the risk of collecting the contractual cash flows is significantly reduced and there are no other indicators for impairment.

Methodology for establishing impairment

The Bank has developed a detailed methodology for the establishment of impairment, which is included in the effective RISK-007/2011 Transaction rating, measurement, and impairment and provisioning rules. See Note 37.6 for a summary of the methodology.

Recognising impairment in the balance sheet

Impairment recognised on expected credit losses is reported by the Bank as follows:
(i.) in the case of financial assets measured at amortised cost, as an amount decreasing gross book value;
(ii.) in the case of financial guarantee contracts and loan commitments, as a provision;
(iii.) if a financial instrument contains both drawn and undrawn components, and the Bank is unable to separate the expected credit loss calculated for the undrawn component from that related to the drawn component, the Bank determines the impairment on the two components in aggregate. The aggregate impairment will decrease the gross book value of the drawn component. If the impairment loss so determined exceeds the gross book value of the drawn component, the difference is recognised by the Bank as a provision.
(iv.) in the case of financial assets measured at fair value through other comprehensive income, the recognised impairment is not shown in the balance sheet as in the case of these the balance sheet value is the fair value. Recognised impairment modifies cumulative other comprehensive income (the Fair value reserve).

2.6.4. Derecognition of financial assets

Loans and debt securities are derecognised (in full or in part) by the Bank if the Bank cannot reasonably expect the return of the financial asset. In the event that the Bank establishes that the debtor's assets or sources of income do not provide sufficient cash flow to pay the cash flows associated with the financial asset, the Bank derecognises the financial asset. Despite the derecognition, the financial assets may still be subject to the Bank's enforcement of its rights in respect of the amounts due.

2.6.5. Designation as measured at fair value through profit or loss

At initial recognition, the Bank classifies some financial assets as measured at fair value through profit or loss, as this designation eliminates or significantly reduces an accounting inconsistency that would otherwise arise.

The Bank designates certain financial liabilities as measured at fair value through profit or loss if any of the following conditions is met:

- the liabilities are managed, measured and reported internally on the basis of their fair value; or

- this designation eliminates or significantly reduces an accounting inconsistency that would otherwise arise.

2.6.6. Hedging transactions

The Bank does not currently use hedge accounting in its statements.

2.6.7. Tangible assets

Recognition and measurement

Tangible assets are recognised by the Bank at cost less accumulated depreciation and impairment.

Purchased software that forms an integral part of a computer-controlled mechanical device are treated by the Bank under tangible assets.

If the useful life of a significant part of an item classified under tangible assets is different, the Bank will treat them as a separate item (as a significant component). If the useful life and depreciation method of a significant component is the same as the useful life and depreciation method used for another significant part of the same asset, the Bank treats those parts as a group for when determining depreciation.

Any property, plant or equipment item is only recognised by the Bank as an asset if and only if:
- it is probable that the future economic benefits attributable to the asset will be realised; and
- its cost can be measured reliably.

The book value of tangible assets items is reviewed by the Bank at established, regular intervals to determine whether the property or equipment item is impaired. To determine whether an item of property, plant or equipment is impaired, the Bank uses the IAS 36 Impairment of assets standard. Impairment and reversal thus determined are recognised in the income statement.

Derecognition

The Bank determines the gain or loss from the derecognition of any item of property or equipment as the difference between the net proceeds from the disposal, if any, and the book value of the asset, and recognises the result under *Other operating income/Other expense* in the Income Statement.

Cost

The items of tangible assets that meet the conditions for recognition as an asset are recognised at cost.

The cost of tangible assets is the sum of the cash or cash equivalents paid for the acquisition of the given asset, or the fair value of any other consideration given for the acquisition of the asset at the time of the acquisition or creation, or, where applicable, the value assigned to the asset at initial recognition in accordance with the specific requirements of other IFRSs.

The Bank measures all costs related to tangible assets at the time the cost is incurred. These costs include the cost of acquiring or producing the asset, as well as any subsequent costs incurred that are associated with supplementing, replacing some part of, or servicing the asset.

The cost of items of tangible assets includes:

- the item's purchase price, including import duties and non-recoverable sales taxes, less any trade and quantity discounts; and
- the costs that can be attributed directly to the fact that the asset was transferred to the place and put in the condition necessary to be able to function properly in accordance with the management's intentions.

Costs subsequently incurred are only recognised in the book value of the asset or recognised in the books as a separate asset when it is probable that the item in question will provide future economic benefits to the Bank and the cost of the item can be measured reliably. Additional costs related to existing assets that prolong the useful life of the asset or extend the asset's scope of use are activated by the Bank. All other repair and maintenance costs are recognised by the Bank as an expense in the income statement at the time they are incurred.

The cost of tangible assets obtained through a finance lease is recognised by the Bank at the fair value of the leased asset or, if this is lower, at an amount equivalent to the present value of the minimum lease payments. Initial direct costs increase the cost of the asset.

Depreciation

Depreciation of tangible assets is recognised by the Bank using the straight-line method and is shown in profit or loss.
The depreciable amount of tangible assets is determined by deducting the residual value of the asset.

Assets obtained through a finance lease are depreciated over the shorter period of the asset's lease term or useful life, unless the Bank has reasonable assurance that it will acquire ownership of the asset by the end of the lease term; in this case the expected term of use will be the useful life of the asset. Pursuant to the requirements of IFRS 16 effective from 01.01.2019, the lease rights included in the assets are depreciated by the Bank over the period for which it has a valid lease agreement. See Note 27 for more information.

Depreciation of an asset begins when it becomes available for use, that is, when the asset is transferred to the place and put in the condition necessary to be able to function properly in accordance with the management's intentions.

The end of an asset's depreciation is the earlier of:
- the date on which the asset is classed as held for sale under IFRS 5 (or on which it is classified as belonging to a "bad Bank" classed as held for sale);
- the date of the derecognition of the asset.

The useful life of the most important items in the Tangible assets category:

• Property, buildings:	6.0%
• Information technology devices:	33.3% (5% residual value)
• Machines, administrative and telecommunication devices:	33.3% (5% residual value)
• Vehicles	20.0% (50% residual value)
• Furniture, equipment	10% (5% residual value)

The depreciation methods, useful lives and residual values are reviewed at each reporting date and, if necessary, adjusted.

2.6.8. Intangible assets

An intangible asset is an identifiable non-monetary asset without physical form. The Bank recognises an intangible asset in its balance sheet if it meets the requirements of identifiability, control over the resource, the existence of future economic benefits, as well as reliable measurement. If an intangible asset does not meet the recognition requirements, the Bank recognises the cost of its acquisition or production as an expense when it is incurred (except for acquisition in a business combination, as this forms part of the goodwill recognised at the date of the acquisition).

Software

Intangible assets consist mainly of software. Computer software often contains both tangible and intangible elements. The Bank determines whether the asset is to be treated in accordance with IAS 16 Property, plant and equipment or IAS 38 Intangible assets by looking at which component of the given asset is more significant. When the software is not an integral part of a particular hardware, the software is treated as an intangible asset by the Bank.

The Bank measures purchased software at cost less accumulated depreciation and impairment.

The cost of the purchased software is the cash or cash equivalent paid for the acquisition, at the time of the acquisition of the given asset, or the fair value of any other consideration given.

The cost of an intangible asset acquired individually includes:

- the item's purchase price, including import duties and non-recoverable sales taxes, less any discounts (trade discounts and quantity discounts); and
- costs directly attributable to the preparation of the device for its intended use.

The subsequent costs associated with the software are activated by the Bank only if they increase the future economic benefits associated with the software. All other subsequent costs are recognised as an expense at the time they are incurred.

The useful life of all software owned by the Bank is fixed. The Bank depreciates software on a straight-line basis over its expected useful life and recognises depreciation in profit or loss.

The Bank does not calculate a residual value for core software and applies a depreciation rate of 10% for these assets. In the case of non-core software, the estimated residual value is 5% and the depreciation rate is 16.67%.

The depreciation methods and useful lives are reviewed by the Bank at each reporting date and, if necessary, adjusted.

Self-funded investments

The Bank recognises various projects as self-funded investments.

In accordance with the general rule relating to intangible assets, the Bank recognises self-funded investments in its balance sheet only if they meet the requirements of identifiability, control over the resource, the existence of future economic benefits, as well as reliable measurement.
For internally produced intangible assets, as required by IAS 38, processes need to be separated into a research and a development phase. Expenditures related to research must be recognised immediately through profit or loss.
Self-funded investments must meet the following additional conditions in order to be activated as intangible assets:
a) they must be technically feasible,
b) an intention to implement must be present,
c) the technical, financial and other conditions necessary for the implementation must be available,
d) an ability to utilise the investment must be present,
e) the investment must demonstrably generate future benefits.

The costs incurred can be activated as an asset only if the conditions (a) to (e) exist concurrently and if they can be reliably measured.

In terms of the eligibility of the costs incurred, IAS 38 requires that only the costs directly incurred for the development can be recognised, such as:
- materials, services directly used by the Bank for the development,
- personnel expenses that were needed for the production.

The Bank's accounts of self-funded investments do not include expenditures related to the research phase, as the settlements for each project begin/began when the given project reaches/reached the development phase.

Of the various costs settled in relation to self-funded investments, IAS 38 only accepts the costs that were incurred directly.

For self-funded investments, the Bank applies a 10% depreciation rate.

2.6.9. Leases

In January 2016, the IASB issued the IFRS 16 (Leases) standard, which will be effective from 1 January 2019. In accordance with IFRS 16, the lessee recognises a "right of use" receivable and a lease liability in its records. The "right of use" receivable is to be recorded in the manner of other non-financial assets, and depreciation must also be recognised on it. The lease liability is to be recorded in the books as the present value of the lease payments to be made during the lease term, discounted based on the internal rate of return of the transaction. As a result of the introduction of the new standard, the Bank writes off the right of use receivables (and lease liabilities) recognised in its balance sheet over 3-5 years. Further details are included in section 2.6.16 of the accounting policy (Standards and interpretations that became effective during the present reporting period) and Note 27, Tangible assets.

The Bank does not act as a lessor, so the requirements of the new standard pertaining to the lessor side are not relevant.

2.6.10. Other assets

Inventories

Inventories include bank cards not yet issued, recognised at their cost or net realisable value, whichever is lower, as required under IAS 2.

- **The cost of inventories** includes all acquisition costs and conversion costs related to the inventories, and all other costs incurred by the Bank in bringing the inventories to their current location and condition.
- **The net realisable value of inventories** is the net amount expected to be realised by the Bank from the sale of inventories in the ordinary course of business.

When determining the cost value of inventories, the Bank uses the FIFO (first in, first out) method.

The Bank determines the net realisable value of inventories once a year using an estimation during year-end closing. The cost of inventories is not recovered if the inventories are damaged, if they become totally or partially obsolete, or if their selling price is reduced. The cost of inventories is also not recovered if the estimated costs of completion or the estimated costs related to their sale have increased. In these cases, the Bank writes the inventories off to their net realisable value.

- When selling inventories, their book value must be recognised as a material expense that forms part of the net operating expenses in the period in which the related income is recognised.
- The amount of any write-down of inventories to their net realisable value and the total loss of inventories must be recognised as a material expense that forms part of the net operating expenses in the period in which the write-off or loss occurs.
- Any amount arising from an increase in the net realisable value – the reversal of any earlier write-down – of inventories is to be recognised as a reduction in the amount of material expenses forming part of the net operating expenses in the period in which the reversal occurs.

2.6.11. Impairment of non-financial assets

At each reporting date, the Bank reviews the book value of its non-financial assets (excluding properties held for investment and deferred tax receivables) to determine whether there is any indication of impairment. Where impairment is indicated, the Bank estimates the recoverable value of the asset. Where there are intangible assets activated in relation to self-funded investments, the Bank reviews their book value annually, regardless of whether there is any indication of impairment.

The recoverable value of an asset or cash-generating unit is the fair value less costs of disposal or the value-in-use of the asset, whichever is higher. The value-in-use is the present value of the expected future cash flows from an asset or cash-generating unit. The present value is determined by the Bank using a pre-tax discount rate that reflects the market's current rating for the time value of money and the specific risks associated with the asset or cash-generating unit.

The Bank recognises impairment if, and only if, the recoverable value of an asset or cash-generating unit is less than its book value; in such cases, the book value of the asset or cash-generating unit is reduced to its recoverable value.

The Bank's corporate assets are assets that do not generate any cash income on their own but contribute to the future cash flows of several cash-generating units. The corporate assets are assigned to cash-generating units on a reasonable and consistent basis by the Bank. In the impairment test, the book value of the cash-generating unit, including the part of the book value of the corporate asset allocated to the given cash-generating unit, must be compared to the recoverable value.

When recognising impairment, the Bank first reduces the book value of the goodwill allocated to the cash-generating unit (group of units), then it proportionately allocates the remaining impairment loss to the other assets belonging to the unit (group of units) on the basis of the book value of each asset of the unit (group of units).

2.6.12. Provisions

A provision is recognised by the Bank if there is an existing obligation resulting from a past event, and it is probable that the fulfilment of the obligation will entail an outflow of resources representing economic benefits to third parties, and a reliable estimate of the amount of the obligation can be made.

The amount recognised as a provision is the best estimate of the expenditure required to settle the existing obligation at the balance sheet date, taking into account the risks and uncertainties inherent in the given obligation.

If the effect of the time value of money is significant, the present value of the expenses expected to settle the obligation is recognised by the Bank as the amount of the provision. The periodic breakdown of the discount is recognised as financing cost.

The Bank creates a provision for reorganisation if it has a detailed formal plan for the reorganisation and has either started the reorganisation or has announced it to those concerned, thereby giving rise to a legitimate expectation in those concerned that it will implement the reorganisation. The reorganisation provision includes only expenditures directly related to the reorganisation that the reorganisation necessarily entails and that are not related to the Bank's continuing operations.

If the Bank has an onerous contract, it creates a provision in the present value of the loss. The Bank considers the lower of the expected costs of termination of the onerous contract and the net cost of performing the onerous contract as the expected loss on the onerous contract. Prior to determining the provision, the Bank recognises impairment for the assets related to the contract, if justified.

The Bank sets aside provisions for taxes and duties if doing so is in compliance with the rules related to the levying of taxes and duties. If the fulfilment of a minimum threshold is required to do this, the provision is recognised when the required threshold is reached.

The Bank also recognises the established expected credit loss on financial guarantees and loan commitments among provisions.

2.6.13. Financial guarantees and loan commitments

A financial guarantee agreement is a contract that requires the issuer to make specific payments to indemnify the owner for a loss resulting from the fact that a specific debtor has failed to pay at the due date in accordance with the original or modified terms of a debt instrument.

Loan commitments provide credit in an obligatory manner at a future date subject to predetermined conditions.

At initial recognition, the Bank measures the issued financial guarantees and the loan commitments that it has provided below market rates at fair value, and then this initial fair value is amortised over the term of the financial guarantee or loan commitment. In the subsequent measurement, the value of financial guarantees and loan commitments is the higher of the amounts of amortised cost and expected credit loss.
All other loan commitments are recognised by the Bank at the amount of the calculated credit loss.

2.6.14. Employee benefits

Defined contribution plans

Defined contribution plans are post-employment benefit schemes where the Bank pays a pre-determined contribution to a separate organisation (fund) without any legal or assumed obligation to pay additional contributions in case the fund's assets are not sufficient to pay all employee benefits related to the employees' employment during the current or prior period.

The Bank makes payments to the following defined contribution plans:

- pension,
- other welfare funds.

The Bank recognises the liabilities of a defined contribution plan as an expense when the related service (work) is performed. The expense is recognised by the Bank in profit or loss, under personnel expenses. Prepaid contributions are recognised by the Bank as an asset in the value of the cash refunds or future decreases in payment it expects.

Defined benefit plans
Any post-employment benefit schemes that do not qualify as a defined contribution plan are treated as a defined benefit plan by the Bank.
Currently, the Bank does not operate any such defined benefit plans.

Other long-term employee benefits

Other long-term employee benefits include items that do not become due within 12 months after the reporting date. They may include:

- long-service leave or sabbatical leave,
- jubilee or other long-service benefits,
- long-term disability benefits,
- profit-sharing, bonuses and deferred compensation.

The net liability from other long-term employee benefits reflects the amount to which the employees are entitled for their service rendered in the current or previous periods. These benefits are discounted by the Bank to their present value. The effect of their revaluation is recognised in profit or loss in the period in which it arises.

Termination benefits

The Bank recognises termination benefits as a personnel expense at the earlier of the following two dates:

- when the Bank is no longer able to withdraw its offer regarding this benefit, or
- when the Bank recognises the reorganisation costs.

If the benefit is not paid in full within 12 months after the reporting date, the Bank will discount these items.

Short-term employee benefits

Short-term employee benefits include:

- wages, salaries and social security contributions;
- paid short-term absences, if the absence is payable within twelve months of the end of the related employment service period;
- profit-sharing and bonuses, if payable within twelve months of the end of the related employment service period; and
- non-monetary benefits for current employees.

Short-term employee benefits are recognised by the Bank as personnel expenses when the related employee service is performed. The Bank will recognise a liability in the amount of the expected payment if the Bank has a legal or assumed obligation to pay the amount as a result of the employee's past service, and the obligation can be estimated reliably.

Share-based benefits

The Bank provides its employees with share-based benefits through the ESOP entity. The benefit is paid by the Bank's shareholders, but it is the Bank that receives the services as a consideration for the benefit, therefore the benefit is recognised by the Bank as a share-based payment transaction settled in equity instruments in accordance with IFRS2.43B(b). The expense or the related increase in equity is recognised in the period in which the employees render the service. When applying to transactions with employees, the Bank must determine the fair value of the services received on the basis of the fair value of the equity instruments granted, as the fair value of the services received typically cannot be determined reliably. The fair value of these equity instruments is to be determined at the date they are granted.

2.6.15. Subscribed capital and reserves

The Bank divides its equity in the balance sheet as follows:

(i.) Subscribed capital
(ii.) Capital reserve
(iii.) Profit reserve
(iv.) Other reserves
(v.) Cumulative other comprehensive income

Cumulative other comprehensive income reflects the cumulative fair value changes and impairment losses of financial assets measured at fair value through other comprehensive income (FVOCI).

2.6.16. Consolidation

2.6.16.1. Consolidation of subsidiaries

Subsidiaries, i.e. companies in which the Bank Group holds more than 50% of the voting rights or whose financial and operating policies are controlled by it in any other way, are consolidated.

Subsidiaries are consolidated from the date on which their control is obtained by the Bank Group (or when the subsidiary is established) and are excluded from consolidation upon the termination of such control. This date may also occur in the course of the year, that is, the exact date of obtainment (or establishment) must be taken into account.

The consolidated financial statements include the profit or loss of the subsidiary's operations from the date on which the acquisition (or establishment) took place, that is, after the control over the acquired subsidiary is actually transferred to the buyer, in which case the profit and loss statement of the subsidiary is to be split between the two periods.

Companies within the Bank Group are required to apply the single accounting policy when preparing their financial statements. If any companies do not apply a single accounting policy, this fact must be indicated in the consolidated financial statements, and the differences must be disclosed. Where there are material differences and their impact on the consolidated financial statements is significant, the differences caused by the different accounting policies in each balance sheet and profit or loss line must be explained. The Bank does not apply any significant differences in its consolidated financial statements from the accounting policies of the Bank Group companies.

2.6.16.2. Capital consolidation

During capital consolidation the book value of the parent company's investment in each subsidiary and the parent company's share in the equity of each subsidiary is eliminated.

The acquisition of a subsidiary is recognised in accordance with the accounting policy for acquisitions. The cost of acquisition includes the fair value, calculated at the date of the acquisition, of the assets transferred, newly issued treasury shares and assumed liabilities. The excess value over the fair value of the subsidiary's net assets and contingent liabilities is recognised as goodwill. The cost of acquisition is the fair value, calculated at the date of the acquisition, of the assets paid, shares issued or liabilities assumed by the acquiring party. The part of the cost of acquisition that exceeds the share in the net assets of the acquired company measured at fair value is recognised as goodwill.

The Bank does not have any subsidiaries acquired through acquisition, its subsidiaries have been established by the Bank itself, so the question of goodwill is not relevant in the consolidated financial statements.

Loss of control: a reduction in ownership interest in a subsidiary that results in a loss of control necessitates a reassessment of the fair value of the remaining interest. If a subsidiary is removed from the consolidation circle, the amount of the remaining interest in the subsidiary must be measured at fair value. The difference between the fair value and the book value is the gain or loss on the derecognition of the interest that is to be recognised through profit or loss. Accordingly, the parent company may only realise any gain or loss on subsequent capital acquisitions of a subsidiary during disposal. The parent company is required to remove a subsidiary from the consolidation when it ceases to have control over it.

2.6.16.3. Debt consolidation of subsidiaries

Transactions and balances, and unrealised profits and losses on the transactions between members of the Bank Group are eliminated.

The receivables, liabilities, accruals, deferrals and provisions existing between the companies involved in the consolidation must be eliminated.

Assets and liabilities of the same title, if their amount is equal, must be derecognised from the preliminary balance sheet against one another.
If their amount is not the same, then of the amount of the difference

- an amount equal to the difference from the previous year must be recognised as a change in equity (profit reserve),

- the amount of the difference between the differences of the current year and the previous year must be recognised in the consolidated income statement as an item adjusting the profit or loss.

Based on the principle of materiality and economy, it is not necessary to carry out the consolidation of the debt with respect to items that do not materially affect the assessment of the Bank's true equity and financial position.

2.6.16.4. Profit and loss consolidation of subsidiaries

Assets acquired from entities belonging to the Bank Group must be recognised in the consolidated balance sheet at the value at which they could have been recognised in the annual balance sheet if the companies legally constituted a single company together.

In order to achieve the above, their interim profit or loss content must be eliminated from the balance sheet value of these assets. If the interim profit or loss eliminated in the current year and the previous year is not the same, then
- the amount of interim profit or loss eliminated in the previous year must be recognised as a change in the Bank's equity (profit reserve),
- and the change in volume (the difference between the eliminated interim profit or loss of the current year and the previous year) must also be recognised in the consolidated income statement as a change in profit or loss.

It is not necessary to consolidate any interim profit or loss that does not significantly affect the assessment of the Bank Group's situation.

2.6.16.5. Income and expense consolidation of subsidiaries

Besides eliminating debts and interim profits or losses generated (from intercompany transactions) within the Bank Group, costs, expenditures and revenues generated within the Bank Group must be consolidated. The purpose of consolidation is to compile an income statement that does not include any accumulation.
During the compilation of the consolidated income statement the following must be eliminated:
- the amount of revenues resulting from the delivery of goods, rendering and use of services between undertakings included in the consolidation, as well as the amount of the related expenditure and direct costs,
- items arising from other business relationships between such companies that are recognised under other income, financial income or extraordinary income or expense in the stand-alone income statement.

2.6.16.6. Deferred tax difference resulting from consolidation

As a final step in the consolidation process, the amount of the deferred tax difference resulting from the consolidation must be determined. In the course of this, the amount of pre-tax profits or losses in the individual accounts are to be compared to the amount of pre-tax profit or loss adjusted as a result of the consolidation (i.e. Bank Group level pre-tax profit or loss).

Of this difference, corporate income tax must be calculated for the amount expected to be balanced out during subsequent years. If the amount of the corporate income tax calculated on the basis of the consolidated income statement is lower than the sum of the amounts of corporate income tax from the individual financial statements, the difference must be recognised as deferred tax receivable arising from consolidation and as a reduction in corporate tax expense.

In the opposite case, the amount of corporate income tax expense must be increased, while simultaneously recognising it as an increase in deferred tax liabilities arising from consolidation. In the consolidated income statement the deferred tax difference arising from consolidation is to be added to the amount of the total deferred tax arising from the stand-alone financial statements.

2.6.16.7. Standards and interpretations that became effective during the present reporting period

The following standards issued by the IASB and adopted by the EU, as well as amendments to existing standards and interpretations, were introduced with effect from the reporting period:

First application of IFRS 16. Leases The Bank has applied IFRS 16 retrospectively from 1 January 2019 and has not modified its comparative figures for 2018, as permitted by the transitional provisions of IFRS 16. The related rights of use have been included in an amount identical to the lease liability, and thus, overall, the new standard has no effect on the opening balance of the profit reserve.

When IFRS 16 was introduced, the Bank recognised lease liabilities on leases that were previously classified as operating leases, in accordance with IAS 17. Leases. These liabilities have been determined at the present value of the outstanding lease payments.

The Bank does not have any operating lease transactions with a remaining term of less than 12 months or of small amounts, and so it has not applied the practical simplifications of this type permitted by the standard. Since none of the lease agreements include an extension option, according to the provisions of the standard the lease liability (and thus the associated right of use) reflects the duration of the remaining term of the existing lease agreements.

The following table shows the reconciliation between the operating lease commitments presented on 31 December 2018 and the lease liabilities recognised on 1 January 2019:
data in HUF millions

	1 January 2019
Amount of future minimum lease fees under non-cancellable operating lease agreements as at 31 December 2018	**347**
Effect of discounting the financial lease liability outstanding on 31 December 2018 *	0
Lease liability presented on 1 January 2019	**347**
Right-of-use assets presented on 1 January 2019	**347**

** Considering the short remaining term (3-5 years) of the existing agreements and the low level of funding costs applicable as a discount rate, the Bank decided not to discount the remaining lease payments when determining the lease liability.*

The change in the accounting policy affected the following items in the financial statements of 1 January 2019:

	Impact of IFRS 16
Increase in right-of-use assets	347
Increase in lease liability	347
Increase/decrease in profit reserve	0

The Bank does not have any finance leases as at 31.12.2019 (even on 31.12.2018 it had only an insignificant liability of this type, at HUF 15 million).

The following standard amendments became effective on 1 January 2019 but had no material impact on the Bank's books:

- Amendment to IAS 12 Income Tax, incorporated in the 2015-2017 annual improvements to IFRSs.

- IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019).
- Prepayment Features with Negative Compensation – Amendments to IFRS 9 (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- Amendments to IAS 28 "Long-term Interests in Associates and Joint Ventures" (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- Annual Improvements to IFRSs 2015-2017 cycle – Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 (issued on 12 December 2017 and effective for annual periods beginning on or after 1 January 2019).
- Amendment to IAS 19 "Plan Amendment, Curtailment or Settlement" (issued on 7 February 2018 and effective for annual periods beginning on or after 1 January 2019).

2.6.17. Future changes in accounting policy

New and amended but not yet effective standards and interpretations issued by the IASB and adopted by the EU

Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020).
The revised conceptual framework includes a new chapter on evaluation; it provides guidance on the presentation of financial performance; it provides better definitions and guidance – in particular on the concept of liabilities, and clarifies important areas such as the role of responsibility, prudence and valuation uncertainty in financial statements.

Definition of Material – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020).

The amendments clarify the definition of materiality and its applicability by integrating it into the guidance on definitions that has so far been included in other parts of the IFRS. In addition, the explanations accompanying the definition have also improved. Finally, the amendments ensure that the definition of materiality is consistent across all IFRSs. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific company. The Bank is currently assessing the impact of the amendments on its financial statements.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture. – Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB).

These amendments address inconsistencies between the requirements of IFRS 10 and IAS 28 in the treatment of sales of assets or contributions between investors and their associates or joint ventures. The primary consequence of the amendments is that the full gain or loss is to be recognised when a transaction affects business activity. Partial profit or loss is to be recognised when a transaction involves assets that do not constitute business activity, even if those assets are held by a subsidiary. As currently the Bank does not have any associates or joint ventures, these amendments are not relevant to its consolidated financial statements.
Standards and interpretations not referred to above are not expected to have a material impact on the Bank's financial statements.

Standards and interpretations issued by the IASB but not adopted by the EU

- IFRS 17 "Insurance Contracts" (effective for reporting periods beginning on or after 1 January 2021),

- Amendments to IFRS 3 "Business Combinations" (effective for reporting periods beginning on or after 1 January 2020).

- Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7 (effective for annual reporting periods beginning on or after 1 January 2020)
- Classification of liabilities as current or non-current – Amendments to IAS 1 (effective for reporting periods beginning on or after 1 January 2022).

The implementation of the above amendments, new standards and interpretations would not significantly affect the Bank's annual financial statements in the period of first application.

3. NET INTEREST AND SIMILAR INCOME

Data in HUF millions

	2019	**2018**
Interest income based on the effective interest method		
Interest income on financial assets held for trading	36	70
Interest income on financial assets measured obligatorily at fair value through profit or loss, not for trading	2	5
Interest income on financial assets designated as measured at fair value through profit or loss	1,282	1,162
Interest income on financial assets measured at fair value through other comprehensive income	310	208
Interest income on financial assets measured at amortised cost	3,852	3,649
Total interest income based on the effective interest rate method	**5,483**	**5,094**
Other interest income		
Interest income on financial assets held for trading	684	534
Miscellaneous	16	-2
Total other interest income	**700**	**532**
Total interest and similar income	**6,183**	**5,626**
Interest expense based on the effective interest method		
Interest expense on financial liabilities designated as measured at fair value through profit or loss	1	1
Interest expense on financial liabilities measured at amortised cost	2,021	2,125
Total interest expense based on the effective interest rate method	**2,022**	**2,126**
Other interest expense		
Interest expense on financial liabilities held for trading	1,057	866
Total other interest expense	**1,057**	**866**
Interest expenses	**3,079**	**2,992**
Total net interest and similar income	**3,104**	**2,634**

4. NET FEE AND COMMISSION INCOME

Data in HUF millions

	2019	2018
Investment services	240	79
Custody services	37	58
Loan and guarantee fees	112	67
Cash flow and account management	1,181	998
Bank card services	329	224
Miscellaneous	146	197
Total fee and commission income	**2,045**	**1,623**
Investment services	0	1
Custody services	17	17
Loan and guarantee fees	132	110
Brokerage commission	1	5
Cash flow and account management	33	36
Bank card services	111	93
Miscellaneous	4	3
Total fee and commission expense	**298**	**265**
Net fee and commission income	**1,747**	**1,358**

Lump sum fees related to the generation of loans are part of the interest calculated with the effective interest method, so they are recognised under interest and similar income and expense over the life of the loan or receivable.

5. PROFIT OR LOSS FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

Data in HUF millions

	2019	2018
Profit or (-) loss from financial assets and liabilities held for trading, net	548	2,438
– profit from securities held for trading	-157	-112
– net profit from derivatives held for trading	304	2,550
– profit or loss from loans held for trading	401	0
Net profit or loss (-) from financial assets measured obligatorily at fair value through profit or loss, not for trading	240	9
Net profit or loss (-) from financial assets designated as measured at fair value through profit or loss	595	-1,124
Net profit or loss (-) from financial liabilities designated as measured at fair value through profit or loss	0	-4
Total net profit from financial instruments measured at fair value through profit or loss	**1,383**	**1,319**

Customer loans

Subsequent measurement of portfolio	Content of portfolio	Fair value profit or loss for 2019	Fair value profit or loss for 2018
For trading	Purchased portfolio	401	0
Measured obligatorily at fair value through profit or loss	Loans that have failed the SPPI test	240	9
- of which "babaváró" loans		223	0
- miscellaneous		17	9
Fixed-rate corporate loans secured by IRSs	designated as measured at fair value through profit or loss	595	-1,124
of which the effect of a change in the premium-calculation method		338	0
Total customer loans		**1,236**	**-1,115**

The gain on held-for-trading loans includes a realised gain on the sale of receivables purchased in 2019 in the amount of HUF 202 million. The total gain on sales was HUF 530 million, which, however, arises from the initial fair value difference of the total purchased portfolio, and thus it was only recognised in the 2019 profit/loss in the amount corresponding to the proportion of part-portfolios derecognised (sold) by the date of preparation of the report. The remaining amount of the gain on loans held for trading – HUF 198 million – is the unrealised gain from the subsequent measurement of the portfolio still on the books.

The net profit/loss from financial assets measured obligatorily at fair value through profit or loss, not for trading, include the profit impact of changes in the fair value of loans that failed the SPPI test. The net earnings figure was largely the result of the follow-up fair value measurement of "babaváró" loans. With respect to the "babaváró" loans, an event that took place between the initial and the subsequent measurement and which can be considered to have a material impact on the measurement was the issuing of a legal opinion by the law firm Allen & Overy on 19 December 2019 at the request of the Banking Association, which significantly reduced the high degree of uncertainty related to the state surety guarantee provided for the loans, an uncertainty that had still existed at the time of disbursement. The Bank also considers it an event taking place after the initial valuation that, in the case of a representative sample (20% of the total portfolio) taken for the year-end follow-up valuation, it obtained additional information about the expected behaviour of customers through telephone inquiries, and used this for estimating the future cash flow. Additional information related to the valuation is provided in Note 23. Fair valuation of financial instruments. The interest income from these instruments is recognised in the interest income line.

The profit/loss from financial assets designated as measured at fair value through profit or loss include changes in the fair value of fixed-rate customer loans and securities to which IRSs treated as hedges from an economic point of view are related. The FVTPL designation is intended to reduce the otherwise existing accounting mismatch. During 2019, the method of calculating the operating cost premium was revised. The effect of this on the fair value profit in 2019 is HUF 338 million. Additional information related to the valuation is provided in Note 23. Fair valuation of financial instruments. The Bank recognises the interest income of the designated assets in its interest income.

Financial liabilities

The profit/loss from financial liabilities designated as measured at fair value through profit or loss include the profit impact of changes in the fair value of MFB liabilities related to MFB refinanced loans that failed the SPPI test. The Bank designated the MFB refinancing liabilities of loans that failed the SPPI test as instruments measured at fair value through profit or loss in order to eliminate an otherwise existing accounting mismatch. The Bank recognises the interest expense of the designated liabilities as interest expense.

Derivatives

The 2018 net profit or loss on trading derivative transactions includes first-day earnings of HUF 1,165 million related to the MIRS transactions (unconditional interest rate swaps with a general scope introduced by the MNB for monetary policy purposes). No similar type of profit or loss arose in 2019.
The net profit or loss of trading derivative transactions includes the fair value of HIRS transactions (interest rate swaps tied to lending activities, introduced by the MNB) (HUF 404 million in 2019, HUF 175 million in 2018). The Bank recognises these transactions at their unconditional fair value (being equal to their market value) and recognises and settles the component of transactions that represents the preferential interest content at the date when the interest rate swap in question occurs and the MNB gives a positive confirmation of the fulfilment of the related condition. The Bank's Management does not consider the MNB's confirmation as automatic, considering the fact that it is preceded by an examination of the fulfilment of the conditions. The Bank recognises the realised interest income from the transactions in the net interest and similar income line. The Bank enforces the discounted interest content of the transactions vis-à-vis the small and medium-sized enterprises to which it grants credit.

6. PROFIT OR LOSS FROM FINANCIAL INSTRUMENTS NOT CLASSIFIED AS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

Data in HUF millions

	2019	**2018**
Impairment of securities measured at amortised cost	0	0
Impairment of securities measured at fair value through other comprehensive income	0	0
Realised profit on sale of securities measured at amortised cost	0	0
Profit realised from the sale of securities measured at fair value through other comprehensive income	0	47
Total net profit from financial instruments not classified as measured at fair value through profit or loss	**0**	**47**

Profit or loss from loans not classified as measured at fair value through profit or loss is recognised by the Bank in the Credit loss and profit line. The Credit loss and profit line also includes the profit or loss from the impairment of securities.

7. DIVIDEND INCOME

The Bank earned HUF 798 thousand in dividend income in 2019 (HUF 540 thousand from the investment in MKB Pannónia Alapkezelő and HUF 258 thousand from its VISA Inc. investment). In 2018 the Bank had received dividend income of HUF 186 thousand from its investments in VISA Inc. and MKB Pannónia Alapkezelő.

8. OTHER INCOME AND EXPENSE

Data in HUF millions

	2019	**2018**
Net profit or loss (-) from the derecognition of non-financial assets	1	-1
Other operating income	94	28
Total other operating income	**95**	**27**

	2019	**2018**
Taxes	35	6

Authority fees	108	127
Resolution Fund	229	146
Claim Settlement Fund	52	53
Other operating expense	38	50
Total other expense	**462**	**382**

9. CREDIT LOSS AND PROFIT

Data in HUF millions

Item	**2019**	**2018**
Individual impairment on loans (net)	-14	69
Collective impairment on loans (net)	-8	6
Total credit impairment	**-22**	**75**
Collective impairment of securities held at amortised cost	0	0
Securities measured at fair value through other comprehensive income	0	-6
Collective impairment of securities	**0**	**-6**
Other (write-offs, recovery from write-offs, impairment of other assets, etc.)	-1	-5
Total credit loss and profit	**-23**	**64**
Provisioning or (-) release of provisions	**-1**	**10**

For further information on changes in profit or loss from impairment and provisioning, see Note 37.6.

10. PERSONNEL EXPENSES

Average number of personnel	**2019**	**2018**
Intellectual workers	133	102
Physical workers	0	0
Management	5	5
Average number of employees in total	**138**	**107**

Data in HUF millions

	2019	**2018**
Wage costs	1,271	1,040
Other expenditure related to personnel	136	119
Social contribution	242	213
Vocational training contribution	19	16
Rehabilitation contribution	11	8
Total gross personal expenses	**1,679**	**1,396**

11. GENERAL ADMINISTRATIVE COSTS

Data in HUF millions

	2019	**2018**

Material costs	45	39
Other operating costs	573	373
IT costs	468	374
Property rentals	18	141
Advertising, commercials	231	213
Membership fees	7	7
Education, further training	5	7
Information line rental	41	22
Expert fees	452	412
Insurance	7	4
Other rentals	0	0
Other non-material services	49	24
Transaction fee	386	377
Special bank tax	589	449
Other general administrative costs	**2,871**	**2,442**

Bank tax

The Bank paid HUF 589 million in bank tax in 2019 (HUF 449 million in 2018). The tax base was HUF 306,781 million for 2019 and HUF 228,209 million for 2018. The effective tax rate was 0.2% in 2019 (0.2% in 2018).

In the case of credit institutions, the tax base in 2019 is the balance sheet total according to IFRS as at 31 December 2017 (in 2018, it was the HAS balance sheet total as at 31 December 2016). In 2019 (and in 2018) the applicable tax rate was 0.15% for the part of the tax base below HUF 50,000 million and 0.21% for the part above HUF 50,000 million.

The tax base of the bank tax imposed on the Bank in 2020 is the IFRS balance sheet total as at 31 December 2018 and the amount of the tax is expected to be HUF 682 million. The Bank's 2020 obligation arises on 1 January 2020.

12. INCOME TAX

The components of income tax for 2019 and 2018 are as follows:

Data in HUF millions

	2019	**2018**
Corporate tax	60	52
Local taxes	134	137
Deferred tax	64	11
Total	**258**	**200**

Corporate tax expense

In 2019 the corporate income tax was 9% on annual profits (also 9% in 2018).
Due to their non-sales nature, local taxes are part of the income tax in the income statement. The local tax includes business tax and innovation tax.
In Hungary there is no agreement on the determination of taxes that would be final from a legal point of view. Within six years of the tax year, the tax authority may review the accounting records at any time and may adjust the tax imposed. Consequently, in the case of a tax authority audit, a tax adjustment may also occur at the Bank. The tax authority reviewed and closed the corporate tax returns of the Bank until 2010; and it also reviewed the Bank's 2015 tax returns. The management is unaware of the existence of any significant tax liability arrears that could arise in years not yet audited by the tax authority.

The effective tax rate applied to the Bank's profit differs from the statutory requirement on account of the following items:

Data in HUF millions

	2019	2018
Profit before tax	**1,376**	**1,240**
Corporate tax rate (%)	**9%**	**9%**
Calculated corporate tax	124	112
Tax implications		
Calculated corporate tax	124	112
Local taxes	134	136
The impact of IFRS transition	-	- 35
Miscellaneous	-	- 13
Income taxes	**258**	**200**
Effective tax rate (%)	18.75%	16.13%

13. LIQUID ASSETS AND EQUIVALENT

Data in HUF millions

	31.12.2019	31.12.2018
Cash	389	414
Account receivables from central banks	2,342	2,701
Other demand deposits	6,115	5,800
Liquid assets and equivalent	**8,846**	**8,915**

14. RECEIVABLES FROM THE MNB AND INTERBANK PLACEMENTS

Data in HUF millions

	31.12.2019	31.12.2018
Receivables from the MNB	96,525	82,103
Interbank placements	35,972	41,271
Total receivables from credit institutions	**132,497**	**123,374**

15. SECURITIES

Data in HUF millions

	31.12.2019	31.12.2018
Credit institution shares	677	899
Other shares	19	27
Equity instruments	**696**	**926**
Discount treasury bills	35,911	14,656
Government securities	23	50
Corporate/bank bonds	0	0
Mortgage bonds	0	0
Total debt securities	**35,934**	**14,706**
Financial assets held for trading	**36,630**	**15,632**
Corporate/bank bonds	49	0
Financial assets measured at fair value through profit or loss	**49**	**0**

	31.12.2019	31.12.2018
Government securities	19,655	40,127
Corporate/bank bonds	10,645	979
Mortgage bonds	4,922	2,398
Total debt securities	**35,222**	**43,504**
Financial assets designated as measured at fair value through profit or loss	**35,222**	**43,504**
Equity instruments	**116**	**149**
Government securities	7,141	7,877
Corporate/bank bonds	0	0
Mortgage bonds	1,522	1,434
Total debt securities	**8,663**	**9,311**
Financial assets measured at fair value through other comprehensive income	**8,779**	**9,460**
OBA/BEVA bonds	4,272	5,134
Financial assets measured at amortised cost	4,272	5,134
Total	**84,952**	**73,730**

Securities designated as measured at fair value through profit or loss are fixed-interest-rate securities whose interest rate risk is, from an economic point of view, hedged by the Bank with IRSs.
The FVTPL designation is intended to reduce an otherwise existing accounting mismatch. In addition to government securities and bank bonds, the portfolio as at 31 December 2019 includes premium corporate bonds purchased within the framework of the Bond Funding for Growth Scheme (BGS) launched by the MNB in 2019, in an amount of 9,648 (the Bank had had no such transactions on its books as of 31 December 2018).

[I1] megjegyzést írt: Is it HUF 9,648 million?

In the case of shares measured at fair value through other comprehensive income, not held for trading, the management has made an irrevocable decision at initial recognition to recognise the change in the fair value of these instruments in other comprehensive income instead of profit or loss. The decision primarily aims to represent the business objective that these shares are not held by the Bank for trading purposes, but rather in an ancillary manner, relating to banking activities.

This category includes the following shares on 31.12.2019:

- VISA Inc. (0.00005415%)
- CO-OP HITEL Zrt. (6.71%)
- Garantiqua Hitelgarancia Zrt. (0.1276%)
- MKB-Pannónia Alapkezelő Zrt. (2%)

The fair value of the listed shares, with the exception of VISA, cannot be reliably established as there is no active market for these shares. In the opinion of the Management, the book value of investments held at cost approximately equals their fair value.

On 31.12.2019 an impairment loss of HUF 1 million was recognised for securities measured at fair value through other comprehensive income (for details, see: Note 20).

Within the discount treasury bills portfolio, an amount in a nominal value of HUF 20,000 million constitutes the subject of an open repo transaction on 31 December 2019; furthermore, of the government securities designated as measured at fair value through profit or loss, items in a nominal value of HUF 11,959 million were also sold with a repurchase obligation. The repo transactions expire on 2 January 2020.

16. DERIVATIVE FINANCIAL INSTRUMENTS

Data in HUF millions

31.12.2019	Nominal value, assets	Nominal value, liabilities	Positive fair value (assets)	Negative fair value (liabilities)
MIRS	23,539	23,539	1,080	373
IRS	30,826	30,826	560	0
Miscellaneous	236	258	2	1
Total derivatives held for trading	**54,601**	**54,623**	**1,642**	**374**
IRSs covering the interest rate risk of securities	23,623	23,623	6	555
IRSs covering the interest rate risk of BGS corporate bonds	9,660	9,660	87	0
IRSs covering the interest rate risk of loans	17,844	17,844	15	186
Total derivative transactions for fair value hedging from an economic point of view	**51,127**	**51,127**	**108**	**741**
Total derivative financial instruments	**105,728**	**105,750**	**1,751**	**1,115**

Data in HUF millions

31.12.2018	Nominal value, assets	Nominal value, liabilities	Positive fair value (assets)	Negative fair value (liabilities)
HIRS	41,150	41,150	0	235
MIRS	16,601	16,601	657	36
IRS	54,225	54,225	1,006	0
Miscellaneous	466	466	0	1
Total derivatives held for trading	**112,442**	**112,442**	**1,663**	**272**
IRSs covering the interest rate risk of securities	40,473	40,473	0	940
IRSs covering the interest rate risk of loans	9,726	9,726	0	51
Total derivative transactions for fair value hedging from an economic point of view	**50,199**	**50,199**	**0**	**991**
Total derivative financial instruments	**162,641**	**162,641**	**1,663**	**1,263**

Derivatives for trading

MIRS transactions have been introduced by the MNB, for monetary policy purposes – they are unconditional interest rate swaps with a general scope. Accordingly, the Bank recognised the difference between the fair value of the initial contract price and the market price of MIRS transactions as first-day profit or loss in 2018 (First-day profit or loss).

Derivatives held, from an economic point of view, for hedging purposes

Derivatives held, from an economic point of view, for hedging purposes are entered into by the Bank to cover the interest rate risk of fixed-interest customer loans and securities (government securities, bank bonds and corporate bonds purchased under the Bond Funding for Growth Scheme). The Bank does not apply hedge accounting to these transactions, but has designated the underlying transactions as measured at fair value through profit or loss to reduce an otherwise existing accounting mismatch.

17. LOANS AND ADVANCES TO CUSTOMERS

Data in HUF millions

	31.12.2019	**31.12.2018**
Held-for-trading loans	5,060	0
Customer receivables measured obligatorily at fair value through profit or loss	1,606	121
Customer receivables designated as measured at fair value through profit or loss	17,540	9,938
Exposure of customer receivables measured at amortised cost	142,932	133,866
Impairment (-)	-90	-111
Net exposure of customer receivables held at amortised cost	142,842	133,755
Total customer receivables	**167,048**	**143,814**

Among held-for-trading customer receivables, the Bank recognises purchased receivables that were purchased in 2019 at a discounted price for sale. The total portfolio purchased at a discounted price was HUF 6,540 million, of which a HUF 1,446 million portfolio was sold in 2019, and an additional HUF 1,017 million portfolio was sold by the Bank to an independent market party in 2020, before the completion of the 2019 annual statements.

Customer receivables measured obligatorily at fair value through profit or loss are customer loans that, based on their business model, would be measured at amortised cost, but as shown by the SPPI test their cash flows do not consist exclusively of principal and interest payment components, so even after their initial recognition they continue to be recognised by the Bank at fair value, and changes in their fair value are recognised through profit or loss. Loans that have failed the SPPI test can be categorised as follows:

- Loans with family housing allowance "CSOK" subsidies for which the subsidy also includes a non-market-based component
- MFB refinanced loans in the case of which the loans are denominated in EUR but repayments are made in HUF, and therefore the transactions also entail a currency risk
- "Babaváró" loans, for which the interest rate scheme also includes a non-market-based component (a scheme launched in 2019; the Bank did not yet have any such transaction on its books in the previous year)

Customer receivables designated as measured at fair value through profit or loss are fixed-interest-rate loans whose interest rate risk is hedged by the Bank with IRSs. The FVTPL designation is intended to reduce an otherwise existing accounting mismatch (the Bank does not apply hedge accounting to these transactions).

The portfolio of loans held at amortised cost includes HUF 14,767 million of transactions financed in the framework of the MNB's Funding for Growth Scheme (NHP Program I and II), the initial fair value of which differs from the transaction price, and the difference is deferred by the Bank over the life of the transactions. As a result of the amortisation of the related effective interest rate, the settlement has no overall impact on profit. The deferred initial difference is HUF 5,614 million and the amount not yet amortised is HUF 1,596 million. For subsequent NHP schemes, the Bank did not identify any initial fair value difference.

18. IMPAIRMENT OF FINANCIAL INSTRUMENTS, PROVISIONS (BALANCE SHEET)

Data in HUF millions

31.12.2019	**Gross exposure**		**Impairment/provisions**		**Net exposure**	
	Receivables	**Guarantees/Undrawn lines**	**Impairment**	**Provision**	**Receivables**	**Guarantees/Undrawn lines**
Customer loans measured at amortised cost						
Retail segment	16,047	146	3	0	16,044	146
Corporate segment	65,553	15,165	19	16	65,534	15,149
Other financial corporate segment	11,898	1,022	1	0	11,897	1,022
Project loans	41,026	4,793	66	1	40,960	4,792
Local municipalities	1,823	0	0	0	1,823	0
Non-profit segment	858	190	1	0	857	190
Bank segment	0	0	0	0	0	0
State segment	4,353	9,967	0	0	4,353	9,967
Total customer loans measured at amortised cost	**141,558**	**31,283**	**90**	**17**	**141,468**	**31,266**
Securities measured at amortised cost						
State segment	4,272	0	0	0	4,272	0
Total securities measured at amortised cost	**4,272**	**0**	**0**	**0**	**4,272**	**0**
Securities measured at fair value through other comprehensive income						
Bank segment	1,522	0	0	0	1,522	0
State segment	7,141	0	1	0	7,140	0
Total securities measured at fair value through other comprehensive income	**8,663**	**0**	**1**	**0**	**8,662**	**0**
Interbank placements						
Interbank placements	35,972	0	0	0	35,972	0
Total interbank placements	**35,972**	**0**	**0**	**0**	**35,972**	**0**

Data in HUF millions

31.12.2018	Gross exposure		Impairment/provisions		Net exposure	
	Receivables	**Guarantees/ Undrawn lines**	**Impairment**	**Provision**	**Receivables**	**Guarantees/ Undrawn lines**
Customer loans measured at amortised cost						
Retail segment	14,293	209	2	0	14,291	209
Corporate segment	69,073	14,956	39	17	69,034	14,939
Other financial corporate segment	7,353	402	2	0	7,351	402
Project loans	39,014	5,806	67	0	38,947	5,806
Local municipalities	2,358	1,195	1	0	2,357	1,195
Non-profit segment	411	160	1	1	410	159
Total customer loans measured at amortised cost	**132,502**	**22,728**	**112**	**18**	**132,390**	**22,710**
Securities measured at amortised cost						
State segment	5,134	0	0	0	5,134	0
Total securities measured at amortised cost	**5,134**	**0**	**0**	**0**	**5,134**	**0**
Securities measured at fair value through other comprehensive income						
Bank segment	1,434	0	0	0	1,434	0
State segment	7,877	0	1	0	7,876	0
Total securities measured at fair value through other comprehensive income	**9,311**	**0**	**1**	**0**	**9,310**	**0**
Interbank placements						
Interbank placements	41,271	0	0	0	41,271	0
Total interbank placements	**41,271**	**0**	**0**	**0**	**41,271**	**0**

The securities measured at fair value through other comprehensive income lines do not include shares classified in this category as they are not subject to impairment.

19. LIABILITIES TO THE MNB AND CREDIT INSTITUTIONS

Data in HUF millions

	31.12.2019	31.12.2018
Funding for Growth Scheme (NHP)	28,350	22,628
Liabilities to the MNB	**28,350**	**22,628**
EXIM	2,188	4,145
FHB	2,251	1,979
MFB	32,628	108
interbank deposits	11,005	8,792
Liabilities to credit institutions	**48,072**	**15,024**
– of this, measured at amortised cost	48,000	14,921
– of this, designated as measured at fair value through profit or loss	72	102

The portfolio of liabilities to the MNB includes HUF 14,767 million of refinancing received in the framework of the MNB's Funding for Growth Scheme (NHP Program I, II), the initial fair value of which differs from the transaction price, and the difference is deferred by the Bank over the life of the transactions. As a result of the amortisation of the related effective interest rate, the settlement has no overall impact on profit. The deferred initial difference is HUF 5,614 million and the amount not yet amortised is HUF 1,596 million. For subsequent NHP schemes, the Bank did not identify any initial fair value difference.

Liabilities to the MNB also include so-called synthetic EUR transactions in an amount of HUF 2,487 million, created with the consolidation of HUF funds drawn under the Funding for Growth Scheme and related CCIRS transactions (foreign exchange rate swaps) concluded with the MNB.

Liabilities to MFB include a repurchase obligation of HUF 32,553 million due to repo transactions opened at the end of the year. The repo transactions expire on 2 January 2020.

Financial liabilities designated as measured at fair value through profit or loss include the MFB refinancing of loans that failed the SPPI test. The Bank designated the MFB refinancing liabilities of loans that failed the SPPI test as instruments measured at fair value through profit or loss in order to eliminate an otherwise existing accounting mismatch.

Refinancing loans

The Bank entered into several refinancing credit line agreements with various financial institutions (FHB – Jelzálogbank, MFB – Fejlesztési Bank; EXIM Bank) to finance part of its activities. The definition of eligible beneficiaries, and the monitoring of the final borrowers and the repayment process are governed by a number of contractual provisions. All credit risks related to the final borrower are borne by the Bank in all cases, and the Bank is also responsible to ensure compliance with all obligations.

In 2013 the National Bank of Hungary (MNB) launched a new programme under the name Funding for Growth Scheme. The aim of the programme is to offer refinancing to small and medium-sized enterprises (SMEs) through the Hungarian banking system. For a temporary period and up to a specified amount, the MNB provides credit institutions participating in the programme with funds at a lower interest rate than the market rate. The credit institutions use these funds to extend loans with similarly favourable conditions to SMEs for specific purposes. The maximum term of the refinancing loans is 10 years at the start and is consistent with the maturity of the loan granted to the customer. Refinancing loans are recognised in the balance sheet as financial liabilities held at amortised cost.

The management of the Bank thinks it is in full compliance with the covenants related to the loans taken out as at 31 December 2019 (and at 31 December 2018).

20. LIABILITIES TO CUSTOMERS

Data in HUF millions

	31.12.2019	31.12.2018
Demand deposits	151,984	162,928
within 3 months	107,039	102,665
Over 3 months, within 1 year	18,292	20,495
between 1 year and 5 years	10,830	4,731
between 5 years and 10 years	10,633	4,204
between 10 years and 15 years	35	112
more than 15 years	0	0
Total liabilities to customers	**298,813**	**295,134**

The Bank recognises its liabilities to customers at amortised cost, and has no liability to customers that it has designated as measured at fair value through profit or loss.

21. ISSUED BONDS

In October 2017 the Bank issued long-term bonds totalling HUF 5,250 million, which also serves as subordinated loan capital and is being used for the expansion of the Bank's business activity. The bond matures on 24.10.2027 with a fixed interest rate of 3.45%.

With a value date of 29 March 2019, the Bank issued a perpetual bond named GRÁNIT 2019/A in the amount of HUF 5,150 million (ISIN code: HU0000358866). The GRÁNIT 2019/A bond could be paid for by offering GRÁNIT 2027/A bonds ("T2 Bonds") issued by the Bank on 24 October 2017. Subscribers of the 2019/A bond used this option, with the exception of a HUF 100 million bond holder. The terms of the GRÁNIT 2019/A bond comply with Article 52 of the CRR and may therefore be considered instruments constituting additional Tier 1 capital ("AT1 Bonds").

The Bank recognises its issued bonds as a liability measured at amortised cost in its balance sheet.

Data in HUF millions

	31.12.2019	31.12.2018
Par value of issued bonds	5,250	5,250
Accrued interest	2	33
Issued bonds	**5,252**	**5,283**

22. FAIR VALUE OF FINANCIAL INSTRUMENTS

Data in HUF millions

31.12.2019	**Fair value**				
	Level 1 input	**Level 2 input**	**Level 3 input**	**Total fair value**	**Book value**
Assets					
Liquid assets and equivalent	8,846			8,846	8,846
Receivables from the MNB		96,525		96,525	96,525
Interbank placements		35,972		35,972	35,972
Securities	34,327	50,504	128	84,959	84,952
- of which:					
Held-for-trading securities	*719*	*35,911*		*36,630*	*36,630*
Securities designated as measured at fair value through profit or loss	*24,908*	*10,314*		*35,222*	*35,222*
Securities measured at fair value through other comprehensive income	*8,700*		*127*	*8,828*	*8,828*
Securities measured at amortised cost		*4,279*		*4,279*	*4,272*
Derivative financial assets		1,751		1,751	1,751
Loans and advances to customers			167,540	167,540	165,705
- of which:					
Held-for-trading customer receivables			*5,060*	*5,060*	*5,060*
Customer receivables measured obligatorily at fair value through profit or loss, not for trading			*1,606*	*1,606*	*1,606*
Customer loans designated as measured at fair value through profit or loss			*17,540*	*17,540*	*17,540*
Customer loans measured at amortised cost			*143,334*	*143,334*	*141,499*

Investments in subsidiaries, joint ventures and associates		1,443	1,443	1,443
Liabilities				
Liabilities to the MNB	60,903		60,903	60,903
Liabilities to credit institutions	17,873		17,873	15,519
- of which:				
Financial liabilities designated as measured at fair value through profit or loss	*72*		*72*	*72*
Financial liabilities measured at amortised cost	*17,801*		*17,801*	*15,447*
Liabilities to customers		298,855	298,855	298,940
Derivative financial liabilities	1,115		1,115	1,115
Issued bonds	6,775		6,775	5,252

	Fair value				
31.12.2018	**Level 1 input**	**Level 2 input**	**Level 3 input**	**Total fair value**	**Book value**
Assets					
Liquid assets and equivalent	8,915			8,915	8,915
Receivables from the MNB		82,103		82,103	82,103
Interbank placements		41,271		41,271	41,271
Securities	50,233	23,329	176	73,738	73,730
- of which:					
Held-for-trading securities	*5,948*	*9,657*	*27*	*15,632*	*15,632*
Securities designated as measured at fair value through profit or loss	*42,525*	*979*		*43,504*	*43,504*
Securities measured at fair value through other comprehensive income	*1,760*	*7,551*	*149*	*9,460*	*9,460*
Securities measured at amortised cost		*5,142*		*5,142*	*5,134*
Derivative financial assets		1,663		1,663	1,663
Loans and advances to customers			146,186	146,186	142,449
- of which:					
Customer receivables measured obligatorily at fair value through profit or loss, not for trading			*121*	*121*	*121*
Customer loans designated as measured at fair value through profit or loss			*9,938*	*9,938*	*9,938*
Customer loans measured at amortised cost			*136,127*	*136,127*	*132,390*
Investments in subsidiaries, joint ventures and associates			1,443	1,443	1,443
Liabilities					
Liabilities to the MNB		26,401		26,401	22,628
Liabilities to credit institutions		15,024		15,024	15,024
- of which:					
Financial liabilities designated as measured at fair value through profit or loss		*102*		*102*	*102*
Financial liabilities measured at amortised cost		*14,922*		*14,922*	*14,922*

Liabilities to customers		295,189	295,189	295,231
Derivative financial liabilities	1,263		1,263	1,263
Issued bonds	5,363		5,363	5,283

Fair value of financial instruments

Financial instruments measured at fair value

The subsequent measurement and recognition of instruments held for trading (including derivative transactions), financial instruments measured at fair value through profit or loss obligatorily or because so designated, as well as instruments measured at fair value through other comprehensive income (OCI), is performed at fair value, as detailed below.

Liquid market products

In the case of liquid market products, the Bank determines the fair value either by applying the market price directly or by applying the relevant market yield curve directly.
In the case of liquid market products, it is not necessary to adjust the applied market price or market yield curve by additional cost elements, as these are actively included in the price and yield curves by the operation of the market.
Typically these include spot and futures products that are standard transactions concluded with government and banking partners and where at least monthly quotes or yield curve quotes are available.
In the case of measurement based on liquid market prices or market yield curves, the Bank classifies the inputs used as level 1 or level 2 inputs under the fair value hierarchy established by IFRS 13.

Non-liquid market products

In the case of non-liquid market products, the Bank discounts the cash-flow elements of the transaction with the discount rate resulting from the sum of the relevant value of the risk-free yield curve and the cost elements assigned to the transaction.

Applicable scope of additional cost elements:

1. risk premium,
2. liquidity premium,
3. operating costs,
4. capital costs.

The risk premium is an excess yield component resulting from credit risk, which risk-averse market participants are likely to expect, being a compensation for the uncertainty inherent in the cash flows of an asset or liability that is the result of the default risk of the counterparty. It can also be designated as "risk adjustment".

The risk premium is derived by the Bank from the expected credit loss determined on the basis of the Bank's credit risk management model applied to the given customer's given transaction, and therefore the risk premium is determined by converting the expected credit loss estimate into a premium.
If available, the Bank may use the premium observed on the liquid market, at bond auctions, or on loans offered through tenders (e.g. bond yield premiums) to determine the risk premium. If internal or external parameters are also available, the Bank prefers to use external parameters.
In the case of transactions where the customer makes a deposit, it is not necessary to take the risk premium into account in proportion to the covered market value (excluding any premiums). If the Bank has entered into a mutual netting and daily margin placement agreement (ISDA, CSA, GMRA) with the counterparty of a transaction, there is no need to apply a risk premium.

The liquidity premium is the premium that represents the surcharge of the resource acquired by the Bank for each maturity period. The premium is determined on a market basis based on the MNB's interest rate statistics.

In determining operating costs, the Bank compares the amount of its operating costs allocated to the given product type to the value of the exposure.
Capital costs are determined by the Bank using the Capital Assets Pricing Model (CAPM), calculated on the basis of the risk-free yield and the value of the risk premium expected for the given investment. Long-term government bond yields (typically that of ten-year government bonds) are used as risk-free yields.

Capital costs are calculated individually for the given transaction and are determined in proportion to the loan portfolio. The calculation process is as follows:

- determining the risk-weighted asset value of a given transaction: the risk weight (RWA) assigned to the exposure value calculated by deducting eligible collateral from the exposure, multiplied by
- the capital adequacy requirement (CAR) expected by the Regulator, multiplied by
- the capital costs determined using the CAPM model, as detailed above.

During the measurements, the Bank prioritises pricing methods, preferring the application of liquid market prices in the first place, and the direct application of liquid market yields in the second place. The pricing of all derivatives and the pricing of most securities are made by the Bank using these methods. Exceptions among the various securities are the corporate bonds purchased under the Bond Funding for Growth Scheme, in respect of which the Management believes that, in the absence of an active market (and because these securities have not yet been listed on the stock market), their fair value is best represented by their cost price.

During 2019, the method for calculating the operating cost premium was revised in view of the fact that the composition of credit transactions measured at fair value during subsequent measurement had changed. While in previous years the Bank had calculated fair value only for transactions designated as measured at fair value through profit or loss (excluding 2 "CSOK" loans and one MFB refinanced loan), in 2019 significant new portfolios were included in this valuation category, such as the "babaváró" loans (HUF 1,457 million) or the purchased portfolio (HUF 5,060 million). Compared to the previously applied method – according to which the Bank determined the premium as a proportion of total operating expenses to the balance sheet total – in 2019 it introduced a differentiated calculation, by comparing the amount of operating expenses allocated to a given product type against the exposure value, thus ensuring that only the costs incurred for the given product are taken into account and a more accurate fair value calculation is made possible.
The impact of the new methodology on loans designated as measured at fair value is as follows:

- Fair value under the old methodology as at 31.12.2019: HUF 17,197 million
- Fair value under the new methodology as at 31.12.2019: HUF 17,535 million

Instruments measured at fair value using level 3 inputs

The Bank uses level 3 inputs for the following financial instruments that are subsequently measured at fair value:

- Customer receivables measured obligatorily at fair value through profit or loss, not for trading
- Customer loans designated as measured at fair value through profit or loss
- Held-for-trading customer receivables
- Securities measured at fair value through other comprehensive income
- Corporate bonds purchased under the Bond Funding for Growth Scheme (BGS)

Loans that are required to be measured at fair value through profit or loss (because they failed the SPPI test, i.e. the future cash flows of the given loan do not only include principal and interest components), and loans designated as measured at fair value through profit or loss are measured by the Bank using the discounted cash flow method, applying the premium components described above.

The balance of held-for-trading loans includes purchased receivables as at 31.12.2019, which the Bank purchased at a discounted price for the purpose of sale, and thus their subsequent measurement falls under FVTPL, i.e. the fair value through profit or loss category. The fair value of these loans is also determined by the Bank based on the discounted cash flow model, applying the premiums detailed above. In making the estimate, the Bank takes into account the fact that it has entered into an agreement with an independent party to whom it may sell the receivables at an option price equal to the purchase price, while the buyer also receives the return on capital above the purchase price, pursuant to the terms of the agreement. Accordingly, the DCF model calculates future capital cash flows only until the purchase price is recovered. A significant event between the initial and the subsequent measurements that affected the valuation was that after the takeover of the portfolio, the Bank gained a better view of the background of the transactions and was able to estimate the expected return more accurately. Also, it can be stated in general that the Bank experienced an improved willingness to co-operate and pay on the part of the majority of customers following the takeover.

Loans obligatorily measured at fair value through profit or loss as at 31.12.2019 include "babaváró" loans in the amount of HUF 1,457 million that were subsequently measured at FVTPL due to their failure to pass the SPPI test. The Bank also estimates the fair value of "babaváró" loans using the discounted cash flow model, estimating the expected cash flows at the transaction level. The Bank assumes that the expected cash flow for "babaváró" loans is most affected by the following factors:

- the woman's age at the time of applying for the loan
- the number of children already born to the family when applying for the loan
- whether an application for suspension has been submitted at the time of the valuation

Based on these factors, the Bank classified customers into groups, assessed the expected behaviour of the groups through a representative sample as well, and determined the expected cash flows for the transactions at an individual level, which it then discounted using a market swap yield curve, adjusted by the premiums detailed above. With respect to the "babaváró" loans, an event that took place between the initial and the subsequent measurement and which can be considered to have a material impact on the measurement was the issuing of a legal opinion by the law firm Allen & Overy on 19 December 2019 at the request of the Banking Association, which significantly reduced the high degree of uncertainty related to the state surety guarantee provided for the loans, an uncertainty that had still existed at the time of disbursement. Firstly, the legal opinion states that the surety guarantee can be used regardless of whether the commitment to have a baby is fulfilled or not; secondly, it concludes that the chances of the EU challenging the scheme on the grounds that such state aid is prohibited, and thus resulting in a possible scrapping of the guarantee, are relatively low. The Bank also considers it an event taking place after the initial valuation that, in the case of a representative sample (20% of the total portfolio) taken for the year-end follow-up valuation, it obtained additional information about the expected behaviour of customers through telephone inquiries, and used this for estimating the future cash flow.

The Bank's non-trading shares are ancillary investments that do not have an active market and in the case of which the Bank's management believes that their book value, which is based on their cost, approximately equals their fair value. An exception to this is the fair measurement of the preference shares of Visa Inc.; these are based on the number of shares owned by the Bank, the exchange rate of quoted Visa Inc. shares and the price of Visa Inc. shares quoted at stock exchanges, adjusted by an illiquidity discount.
The fair value of bonds purchased under the Bond Funding for Growth Scheme cannot be determined reliably, given that they do not have an active market, and their stock-market listing has largely not yet taken place. The Management believes that the market value of these bonds is best represented by their cost price.

The effect of premiums as non-observable components on fair values is as follows:

Data in HUF millions

Customer loans	**31.12.2019** Fair value with premium	Fair value without premium	effect of premium component
For trading	5,060	5,152	-92
Obligatorily measured at fair value	135	141	-6
Designated as measured at fair value	17,535	18,095	-560

The for-trading transactions include the purchased receivables; as at 31.12.2018 the Bank had not had any such item on its books.

Customer loans	**31.12.2018** Fair value with premium	Fair value without premium	effect of premium component
Obligatorily measured at fair value	121	120	1
Designated as measured at fair value	9,938	10,229	- 291

Among the securities measured at fair value through other comprehensive income, the Bank uses an unobservable component for the fair valuation of its investment in VISA Inc.: It includes a multiplier of 0.9 in the calculation as a liquidity premium.

Among financial instruments measured at fair value under the subsequent measurement, there was no transfer between the levels of the measurement hierarchy either in 2019 or in 2018.

For the results of fair value measurement, see Note 6 "Profit or loss from financial instruments measured at fair value through profit or loss".

Financial instruments not measured at fair value

In the following we present the methods and assumptions used to quantify the fair value of financial instruments that are not held at fair value through profit or loss in the financial statements and their subsequent measurement is based on their amortised cost. The fair value of these instruments is determined only for presentation in the Notes to the accounts.

Securities held at amortised cost

At present, this portfolio of the Bank only includes OBA and BEVA variable-rate bonds, the fair value of which is determined by the Bank by the direct application of the market yield curve.

Customer loans and interbank transactions held at amortised cost, liabilities held at amortised cost

In the case of liquid assets and liabilities or those with a short remaining term (less than 1 year), the Bank assumes that their book value, based on their amortised cost, approximately equals their fair value. This assumption also applies to demand assets and liabilities, savings assets and liabilities without a specific maturity, and floating-rate assets and liabilities.
The estimated fair value of fixed-rate liabilities held at amortised cost with a residual maturity of over 1 year (including refinancing liabilities) is determined using the discounted cash flow calculation method on the basis of the market yield curve corresponding to the remaining maturity. In the case of customer deposits, the Bank discounts future cash flows at market rates determined on the basis of MNB statistics by major segment (retail/corporate; HUF/EUR; savings of less/more than 2 years).
The fair value of fixed-rate assets held at amortised cost with a residual maturity of over 1 year is determined using the discounted cash flow calculation method on the basis of the estimated market

yield curve of the asset, corresponding to the remaining maturity, applying the premium components described above.

The Bank believes that the book value, less impairment, is the best approach to the fair value of defaulted transactions classified in basket 3, during the calculation of which an individual cash flow stress method is used to determine the value of the transaction and therefore no non-realised profit or loss is recognised for these transactions in these Notes.

23. OTHER INFORMATION RELATING TO FINANCIAL INSTRUMENTS

Assets used as collateral for liabilities and contingent liabilities

Data in HUF millions

	31.12.2019	31.12.2018
Assets that are used as collateral for the following liabilities:		
MNB Funding for Growth Scheme	30,060	22,748
Derivatives	1,670	1,901
FHB refinancing loans	2,251	1,978
Total assets used as collateral	**33,981**	**26,627**

The assets used as collateral for the MNB Funding for Growth Scheme are partly government securities held by the company, recognised in the balance sheet in the Securities line (HUF 4,577 million on 31.12.2019, HUF 4,266 on 31.12.2018), and the remaining part consists of collateral behind loans disbursed under the programme (property and other collaterals).

Assets used as collateral for derivative transactions consist of interest rate swap collateral accounts, which are recognised in the balance sheet in the Receivables from MNB line.

Behind the refinancing loan portfolio provided by FHB, the collaterals consist of loans granted to customers, recognised in the balance sheet under loans and advances to customers measured at amortised cost (HUF 2,251 million on 31.12.2019).

Transferred financial assets

As at 31 December 2019, the Bank had 3 open repo transactions, of which its repurchase obligations to MFB amounted to HUF 32,553 million in total. The Bank recognises the liability at amortised cost in the balance sheet line 'Liabilities to credit institutions' (see Note 20). The Bank recognises securities transferred to repo in the 'Securities' line of the balance sheet (see Note 15). The Bank did not have any other transferred financial assets.

As at 31 December 2018, the Bank did not have any open repurchase agreements or any other financial instruments transferred.

Offsetting of financial assets and liabilities

The following tables show the financial assets and liabilities that are subject to an enforceable, primary netting agreement as at 31 December 2019:

Data in HUF millions

31.12.2019	Volumes stated in the balance sheet		
	Gross value of financial assets	Gross value of financial liabilities to be offset	Net value of financial assets

Derivatives	1,751		1,751
Total financial assets subject to offsetting or primary netting agreements	**1,751**		**1,751**

	Volumes stated in the balance sheet		
	Gross value of financial liabilities	Gross value of financial assets to be offset	Net value of financial liabilities
Derivatives	1,115		1,115
Total financial liabilities subject to offsetting or primary netting agreements	**1,115**		**1,115**

Data in HUF millions

31.12.2018	Volumes stated in the balance sheet		
	Gross value of financial assets	Gross value of financial liabilities to be offset	Net value of financial assets
Derivatives	1,663		1,663
Total financial assets subject to offsetting or primary netting agreements	**1,663**		**1,663**

	Volumes stated in the balance sheet		
	Gross value of financial liabilities	Gross value of financial assets to be offset	Net value of financial liabilities
Derivatives	1,263		1,263
Total financial liabilities subject to offsetting or primary netting agreements	**1,263**		**1,263**

The derivatives are subject to the following netting agreements: ISDA (International Swaps and Derivatives Association) agreements, CSAs (Credit Support Annexes) and GMRAs (Global Master Repurchase Agreements). The Bank has no open repurchase or reverse repurchase (repo) transactions on the reporting dates.

The Bank has no primary netting agreements, the financial assets and liabilities under which are not offset against each other in the balance sheet.

Financial asset reclassifications due to a business model during the year

The Bank did not reclassify any financial assets in its asset portfolio due to a business model either in 2019 or in 2018.

Information on credit, market and liquidity risk management

Information on the management of credit, market and liquidity risks of the Bank is provided in Note 37 on Risk management.

24. OTHER ASSETS

Data in HUF millions

	31.12.2019	31.12.2018
Receivables from founders	0	0
Banking operation stocks	10	12
Advances	99	10
Central budget subsidies	50	34
Buyers	226	117
Deferred operating costs	33	46
Bank card activity settlements	561	546
Account management settlements	94	170
Other receivables	262	25
Other assets	**1,335**	**960**

Of the other assets, items recognised in the Buyers line are classified as financial instruments, which were mainly received in January 2020.

25. INTANGIBLE ASSETS

Change in intangible assets (2019)
Data in HUF millions

	Cost (gross value)			
Change in the gross value of intangible assets (2019)	Opening	Increase	Decrease	Closing
Concessions, licences and similar rights	13	0	0	13
Intellectual property	1,092	278	4	1,366
Gross value of intangible assets	**1,105**	**278**	**4**	**1,379**

	Accumulated depreciation			
Accumulated depreciation of intangible assets	Opening	Increase	Decrease	Closing
Concessions, licences and similar rights	8	1	0	9
Intellectual property	456	119	0	574
Accumulated depreciation of intangible assets	**463**	**120**	**0**	**584**

Net value of intangible assets	31.12.2019
Concessions, licences and similar rights	4
Intellectual property	792
Net value of intangible assets	**796**

Change in intangible assets (2018)

Data in HUF millions

	Cost (gross value)			
Change in the gross value of intangible assets	**Opening**	**Increase**	**Decrease**	**Closing**
Concessions, licences and similar rights	13	0	0	13
Intellectual property	979	133	21	1,092
Gross value of intangible assets	**992**	**134**	**21**	**1,105**

	Accumulated depreciation			
Accumulated depreciation of intangible assets	**Opening**	**Increase**	**Decrease**	**Closing**
Concessions, licences and similar rights	6	1	0	8
Intellectual property	354	102	0	456
Accumulated depreciation of intangible assets	**360**	**103**	**0**	**463**

Net value of intangible assets	**31.12.2018**
Concessions, licences and similar rights	6
Intellectual property	636
Net value of intangible assets	**642**

26. TANGIBLE ASSETS

Change in tangible assets (2019)

Data in HUF millions

	Cost (gross value)			
Change in the gross value of tangible assets (2019)	**Opening**	**Increase**	**Decrease**	**Closing**
Property and related concessions, licences and similar rights	39	508	0	547
Equipment, machinery and vehicles	397	196	6	587
Gross value of tangible assets	**436**	**704**	**6**	**1,134**

	Accumulated depreciation			
Accumulated depreciation of tangible assets (2019)	**Opening**	**Increase**	**Decrease**	**Closing**
Property and related concessions, licences and similar rights	16	126	0	142
Equipment, machinery and vehicles	268	57	1	324
Accumulated depreciation of tangible assets	**284**	**183**	**1**	**466**

Net value of tangible assets (2019)	**31.12.2019**
Property and related concessions, licences and similar rights	406
Equipment, machinery and vehicles	263
Net value of tangible assets	**668**

Change in tangible assets (2018)

Data in HUF millions

Change in the gross value of tangible assets (2018)	Cost (gross value)			
	Opening	**Increase**	**Decrease**	**Closing**
Property and related concessions, licences and similar rights	39	0	0	39
Equipment, machinery and vehicles	372	31	5	397
Gross value of tangible assets	**411**	**31**	**5**	**436**

Accumulated depreciation of tangible assets (2018)	Accumulated depreciation			
	Opening	**Increase**	**Decrease**	**Closing**
Property and related concessions, licences and similar rights	14	2	0	16
Equipment, machinery and vehicles	236	33	1	268
Accumulated depreciation of tangible assets	**249**	**35**	**1**	**284**

Net value of tangible assets (2018)	**31.12.2018**
Property and related concessions, licences and similar rights	23
Equipment, machinery and vehicles	129
Net value of tangible assets	**152**

On 31.12.2019, 'Property and related concessions, licences and similar rights' include property lease rights in the amount of HUF 253 million, which the Bank recognised as an asset in its balance sheet in accordance with the requirements of IFRS 16 effective from 1 January 2019. The lease right embodies the lease rights of the Bank's head office, branches and parking spaces, which the Bank will write off over 3-5 years, in accordance with its lease agreement in force.

Recognised rights of use apply to the following types of devices:

Data in HUF millions

	Cost (gross value)			
	Opening	**Increase**	**Decrease**	**Closing**
Real estate	332	26		358
Parking spaces	15			15
Gross value of rights to use assets	**347**	**26**	**0**	**373**

	Accumulated depreciation			
	Opening	**Increase**	**Decrease**	**Closing**
Real estate	0	115		115
Parking spaces	0	5		5
Gross value of rights to use assets	**0**	**120**	**0**	**120**

The Bank made investments in its leased properties in the amount of HUF 136 million in 2019 (which is not included in the Rights of use movements table, as it is not a right of use).

27. DEFERRED TAX RECEIVABLES AND TAX LIABILITIES

Deferred tax and its changes recognised in the balance sheet:

31 December 2019

Data in HUF millions

	Asset	Liability	Profit	Equity
Fair value difference of securities – instruments measured through comprehensive income	**1**	**0**	**0**	**-10**
Tax adjustment items				
Intangible assets and tangible assets	-8	0	-12	0
Impairment	0	0	0	0
Credit provision	2	0	0	0
Total tax adjustment items	**-5**	**0**	**-13**	**0**
Accrued losses	149	0	-51	0
Total deferred tax	**144**	**0**	**-64**	**-10**

31 December 2018

Data in HUF millions

	Asset	Liability	Profit	Equity
IFRS transition				
Intangible assets and tangible assets	0	0	4	0
Correction of amortised cost of loans	0	0	-8	0
Loans obligatorily measured at fair value	0	0	-1	0
Loans designated as measured at fair value	0	0	14	0
Amortised cost of securities	0	0	-161	0
Fair value difference of securities	0	0	384	0
Fair value difference of securities – instruments measured through comprehensive income	0	0	0	9
Impairment	0	0	-4	0
Credit provision	0	0	-1	0
Refinancing loans designated as measured at fair value	0	0	-1	0
Refinancing loan under the MNB Funding for Growth Scheme	0	0	0	0
Synthetic EUR loan	0	0	1	0
Fair value difference of derivatives	0	0	-193	0
Total impact of IFRS transition	**0**	**0**	**34**	**9**
Fair value difference of securities – instruments measured through comprehensive income	**10**	**0**	**0**	**10**
Tax adjustment items				
Intangible assets and tangible assets	**4**	**0**	**4**	**0**
Impairment	**0**	**0**	**0**	**0**
Credit provision	**2**	**0**	**2**	**0**
Total tax adjustment items	**6**	**0**	**6**	**0**
Accrued losses	200	0	-52	0
Total deferred tax	**216**	**0**	**-12**	**19**

The Bank recognises the profit effect of deferred tax in the Income taxes line.
As the total amount of accrued losses was generated before 1 January 2015, it can be used indefinitely.

28. PROVISIONS

The development of provisions related to lending activities is detailed in Note 18, together with the development of impairment. In addition to the provisions related to lending activities, the Bank's books include a provision of HUF 7 million (HUF 7 million both as at 31 December 2018), related to legal issues.

29. OTHER LIABILITIES

Data in HUF millions

	31.12.2019	31.12.2018
Supplementary payments by owners	0	0
Suppliers	43	60
Leasing liabilities	242	15
Liabilities to central budget	262	217
Account management settlements	407	32
Accrual of operating costs	247	145
Accrual of bonuses	316	340
Accrued income	328	0
Total other liabilities	**1,845**	**809**

Of the other liabilities, items recognised in the Suppliers line are classified as financial instruments, which have been settled by the date of approval of the statements.

30. SUBSCRIBED CAPITAL

	31.12.2019	31.12.2018
Issued ordinary shares in circulation, no.	8,493,955	8,493,955
The nominal value of issued ordinary shares in circulation is HUF 1,000.	8,493,955	8,493,955

Shareholders of the Bank:

Shareholders of the Bank:	31.12.2019	31.12.2018
E.P.M Kft. (Éva Hegedűs Chairperson & CEO)	61.20%	61.20%
ESOP	14.32%	14.32%
MKB Pension Fund	9.98%	9.98%
Pannonia Pension Fund	9.95%	9.95%
Gold Taurus	1.95%	1.95%
Coop Innova	0.64%	0.64%
Jenő Siklós (Deputy CEO)	0.63%	0.63%
Small investors	1.34%	1.34%
Total	**100.00%**	**100.00%**

In 2010, the year when the Bank's operations were started, the Bank had two shareholders, companies owned by Sándor Demján and Éva Hegedüs. Later the Bank's ownership structure gradually expanded to include private investors and in 2013 the Hungarian State became a minority owner. The state acquired a stake in the Bank strictly on a market investment basis, with the management rights retained by the private investors.
In 2017 the Bank's subscribed capital was raised; Pannónia Pension Fund and MKB Pension Fund subscribed for a total of HUF 385 million while the GRÁNIT Bank ESOP entity subscribed for HUF 1,216 million of newly issued ordinary shares.
The Hungarian State announced an open, two-round tender on 20 July 2017, for the sale of its shareholding in the Bank. The winning bidder in the tender was E.P.M. Kft., and the official

announcement to such effect was made on 22 December 2017. The ultimate controlling owner of the Bank is the owner of EPM Kft., CEO Éva Hegedűs.
Established in 2017, the ESOP Entity enables employees specified in the ESOP Remuneration Policy, subject to the conditions set forth therein, to acquire, conditionally, ordinary shares issued by the Bank, with the intention that by acquiring a direct stake in the Bank they will be motivated to contribute, in their capacity as owners, to the effective and profitable risk management of the Bank, to the successful implementation of the Bank's strategy, and to increasing shareholder value.

31. CONTINGENT RECEIVABLES AND LIABILITIES

In its ordinary course of business, the Bank Group concludes business transactions with financial instruments related to loans that carry off-balance-sheet risk. This includes credit lines, financial guarantees, and letters of credit. These instruments contain credit risk elements that exceed the amounts recognised in the balance sheet.
The credit risk of off-balance-sheet financial instruments means the possibility of loss arising from the non-contractual performance of any other party to the financial instrument. With respect to contingent liabilities, the Bank Group follows the same lending policy as in the case of financial instruments in the balance sheet, from approval procedures to risk management limits to monitoring processes.
Credit lines are contractual agreements for the provision of credit, usually with a fixed or otherwise specified maturity, and with payment obligations. The potential credit loss is less than the amount of undrawn funds, since in the case of most credit lines provision of the credit depends on the customer's compliance with the terms to be fulfilled. As many credit lines are expected to expire without the credit being actually drawn down, the amount of the commitments does not necessarily reflect future cash needs.
Issued financial guarantees are contingent liabilities by which the Bank Group guarantees the performance of one of the Bank's customers to a third party. The credit risk inherent in the issuance of a guarantee is essentially the same as in the case of lending to other customers. When determining the probability of loss resulting from the guarantee, the Bank Group applies the same principles as for the establishment of the provision to be generated for potential loss of other credit lines.
Letters of Credit are financing transactions between the Bank Group and a customer, where the customer is usually the buyer/importer whereas the beneficiary is typically the seller/exporter of goods. The credit risk is limited, as the delivered goods serve as collateral for the transaction.
The Bank Group generates provisions for the credit risk of its contingent liabilities related to its lending activities as detailed in Note 20 to the financial statements.

The Bank Group's contingent receivables and contingent liabilities related to lending are as follows:

Data in HUF millions

	31.12.2019	**31.12.2018**
Contingent liabilities	**33,195**	**24,787**
Guarantees:	2,047	1,850
Revolving loan:	13,754	9,607
Approved credit lines	17,378	13,314
Miscellaneous	16	16
Contingent claims	**235,984**	**181,481**
- Guarantees and received sureties	7,855	2,171
Real estate received as collateral	113,899	84,464
Guarantees received from the Hungarian state	19,819	6,378
Other guarantees	90,728	84,830
Received credit lines	3,683	3,638

32. TRANSACTIONS WITH RELATED PARTIES

The concept of related party includes the entities that are directly or indirectly under the control of the Bank Group, have an influence over the Bank Group, are controlled by the same entity as the Bank Group, as well as associates and the management of the Bank Group.

Parent company: E.P.M. Kft. 61.2%
In the years 2019 and 2018 the Bank had no receivables or liabilities to its parent company.

Management in key position

The management of the Bank Group includes the members of the Board of Directors, the members of the Supervisory Board, the Chief Executive Officer and the Deputy Chief Executive Officers.

Data in HUF millions

	Credit		Deposit	
	31.12.2019	**31.12.2018**	**31.12.2019**	**31.12.2018**
Board of Directors	0	0	5	4
Supervisory Board	0	0	3	0
Management	135	101	31	252
Total	**135**	**101**	**39**	**256**

Credit and deposit transactions with the management were concluded with market conditions. The above table does not include the amount of loans granted under the ESOP, which was HUF 901 million.

Compensation paid to the management for the financial year

2019

Item	**Number of persons receiving compensation**	**Wages and other short-term benefits**	**Multi-year incentive benefits**	**Share-based benefits**
Board of Directors – Management	5	201	32	31
Supervisory Board	3	7	0	0
Total	8	208	32	31

2018

Item	**Number of persons receiving compensation**	**Wages and other short-term benefits**	**Multi-year incentive benefits**	**Share-based benefits**
Board of Directors – Management	6	216	65	31
Supervisory Board	4	17	0	0
Total	**10**	**233**	**65**	**31**

33. DEFINED BENEFIT PLANS

The Bank Group manages its Remuneration Policy by defining remuneration principles ensuring a safe and prudent operation that is in line with the Bank's business strategy, goals, values, and the long-term interests of the organisation, as well as an effective and efficient risk management, and in harmony with all of these ensures the increase of shareholder value.

The Remuneration Policy applies to all employees of the Bank Group, with a particular focus on senior executives and employees with risk-taking and control functions as defined in the Internal Rules and employees in the same remuneration category as the above, whose activities have a material impact on the risk taking of the Bank Group.

The Bank Group's System of Remuneration consists of the following:

- Basic wage,
- Fringe benefits,
- Annual bonus,
- Target bonus (project bonus),
- Rewards,
- Participation in ESOP Entity.

Annual bonus, reward

Data in HUF millions

	31.12.2019	31.12.2018
Liability at the beginning of the period	**340**	**377**
Payment	-202	- 209
Reversal*	0	- 54
Training	178	226
Liability at the end of the period	**316**	**340**

*Reversal is the release of bonuses accrued in previous periods by employees who are leaving the company

Employee Stock Ownership Plan (ESOP)

On 14 March 2017 the Bank's Board of Directors decided to establish the GRÁNIT Bank Employee Stock Ownership Plan (ESOP) Entity, of which the Bank remains the sole owner. The ESOP Entity used all of the founder's equity of HUF 1,343 million, placed at its disposal by the Bank (1,216,343 shares at a price of 110.43%), for the subscription of ordinary shares issued by the Bank. From the beginning of the plan until 31.12.2019 no new shares were added or no shares were withdrawn from the plan.

The purpose of the ESOP Remuneration Policy is to transfer ordinary shares issued by the Bank to the employees and senior executives of Bank, subject to conditions, with the intention that by acquiring a direct stake in Bank they will be motivated to contribute, in their capacity as owners, to the effective and profitable risk management of Bank as prescribed in the Act on Credit Institutions and Financial Enterprises, and to increasing shareholder value.

The duration of the ESOP plan is 3 years, fulfilment conditions are set out in the ESOP Statutes and the Remuneration Policy. The benefit is paid by the Bank's shareholders, but it is the Bank that receives the services as a consideration for the benefit, therefore the benefit is recognised by the Bank as a share-based payment transaction settled in equity instruments in accordance with IFRS2.43B(b). The expense or the related increase in equity is recognised in the period in which the employees render the service, i.e. over the 3 years of the plan, in a linear manner. The Bank must determine the fair value of the services received on the basis of the fair value of the equity instruments granted, as the fair value of the services received typically cannot be determined reliably. The Bank determined the fair value using a methodology based on scenario analysis, estimating the value of the likely share price increase resulting from the service provided by the employees participating in the plan. The fair value at the time of the provision was HUF 138.5 million, and correspondingly the increase in equity and cost per year was HUF 46.2 million.

34. COMPENSATION OF THE AUDITOR

Data in HUF millions

	2019	2018
Fees for statutory audit services	25	19
Fees for non-audit services provided by a statutory auditor	23	25
Fees for services provided by other audit firms	13	0

Total fees paid to audit firms	**61**	**44**

As required by the Accounting Act, the Bank is a company subject to an audit. In 2019 (and in 2018) PricewaterhouseCoopers Könyvvizsgáló Kft. provided statutory audit services to the Bank.
Non-audit services provided by a statutory auditor include other fees related to accounting advice.
The fees for services provided by other auditing firms include legal services and tax advisory fees.

35. NOT EXCLUSIVELY OWNED SHARES

The Bank Group has less than 100% ownership in the following company:

- Name of share: GRÁNIT Bank ESOP Entity
- Head office of share: Budapest, 1095 Lechner Ödön fasor 8.
- Share of the Bank Group: 50%
- Share of non-controlling owners: 50%
- Share of non-controlling owners in comprehensive income: HUF 8 million in 2019 (HUF 7 million in 2018)
- Share of non-controlling owners in accumulated earnings: HUF 18 million on 31.12.2019 (HUF 10 million on 31.12.2018)

Financial information on the share:

Data in HUF millions

Item	**31.12.2019**	**31.12.2018**
Assets		
Liquid assets and equivalent	1	0
Customer loans measured at amortised cost	1,344	1,365
Investments in affiliated undertakings	1,344	1,344
Other assets	36	0
TOTAL ASSETS	**2,724**	**2,709**
Liabilities		
Income tax payment liability	0	0
Deferred tax liability	0	0
Other liabilities	0	0
TOTAL LIABILITIES	**0**	**0**
Equity		
Subscribed capital	1,343	1,343
Capital reserve	1,344	1,344
Profit reserve	37	22
of which this year's profit/loss	17	15
TOTAL EQUITY	2,724	2,709
Liabilities and equity	**2,724**	**2,709**

36. EVENTS AFTER THE BALANCE SHEET DATE

Due to the spread of the coronavirus, the WHO declared an international epidemiological emergency on 30 January 2020. For the purposes of "IAS 10 Events after the Reporting Period", the spread of the coronavirus epidemic qualifies as 'a non-adjusting event' (an event that does not adjust the financial balances in the statements).

The Hungarian government declared a state of emergency and ordered a number of health protection measures to slow the spread of the virus, and on 18 March 2020 it published its first economic package, of which the most important measures affecting the banking sector are as follows:

- A repayment moratorium will be introduced for all private individuals and businesses, which will include both principal and interest payments. The moratorium applies to transactions concluded by 18 March 2020 at the latest. The moratorium expires on 31 December 2020. Any interest unpaid as a result of the 2020 repayment moratorium will not be capitalised, and will only be paid at a later date. Customers have the opportunity to change their intention to participate in the moratorium at any time during the entire period of the moratorium.
- From 19 March 2020, the interest terms on unsecured loans will be regulated, with the central bank interest rate being capped at +5%.

As the measures related to the virus are being implemented continuously and suddenly, the analysis of the financial impact of the epidemic is still ongoing and this impact cannot be reliably estimated as at the time of approval of the report. The Bank will take into account the impact of the epidemic on macroeconomic variables when estimating impairment in accordance with IFRS 9 for 2020.

37. RISK MANAGEMENT

The Bank Group's risk management policies are identical to the Bank's custom risk management policies as the companies included in the consolidation, due to the low number of their transactions and their effect on the consolidated statements – do not necessitate the use of additional risk management policies that are different from custom one. However, the numerical data presented in these Notes have been prepared on a consolidated basis.

37.1. Risk Management Committees

The **Asset-Liability Committee** ("ALCO") is a standing committee set up by the Board of Directors. It has, within specified limits, decision-making rights concerning the management of the Bank's assets and liabilities and related risk management and capital adequacy issues. The detailed rules of operation of the committee are defined in a separate regulation. The Committee had 13 meetings in 2019.

The **Credit Committee** ("CC") is a standing Committee set up by the Board of Directors. It has decision-making rights concerning Gránit Bank's risk-taking, as well as issues related to risk-taking and its monitoring. The detailed rules of operation of the committee are defined in a separate regulation. The Committee had 50 meetings in 2019.

The **Problem Claims Committee** ("PCC") is a standing committee set up by the Board of Directors. It has decision-making rights to recover Gránit Bank's overdue receivables, to conduct activities concerned with other breaches of contract or other facts, and to monitor, manage and recover the Bank's claims and commitments related to problematic claims and partners. The detailed rules of operation of the committee are defined in a separate regulation. The PCC did not hold a meeting in 2019; in some cases there was a written vote.

37.2. Risk strategy, processes, scope

The Bank manages its risks prudently, conservatively, and makes sure that its customers should not become indebted to an extent over their capacity of repayment, which must not be exceeded even during a potential economic turbulence.

The Bank's portfolio of assets is of impeccable quality thanks to the Bank's exceptionally well-regulated and conservative risk-taking policy.

Since 2010 the Bank has used the standard method for calculating the credit and market risk capital requirement in Pillar I, while it uses the basic indicator method for calculating the capital requirement for operational risk.

The Bank develops its portfolio in compliance with conservative risk management and prudent business policy to ensure the best possible quality of it. As part of its risk management strategy and policy, the Bank uses the following tools:

- The ultimate goal of all of the Bank's business activities is to make a profit of sufficient magnitude in the long term.

- The Bank's strategy for defining asset-side growth targets is to build a high-quality portfolio from a risk point of view, seeing the quality of the portfolio first and foremost as opposed to quantitative growth.
- The business and risk management functions are jointly responsible for the quality of the Bank's asset portfolio.
- An independent risk management function has been established, separate from the business area within the organisation, and directly reporting to the Bank's Chairperson and CEO as an organisational unit.
- Those responsible for Compliance and Anti-Money Laundering (hereinafter: AML) perform their activities, in terms of organisation, separately from operating and risk taking processes.
- The prudent and conservative risk management policies are regularly reviewed by the Bank, so they were also reviewed in 2019. It is part of the Bank's risk-taking policy that it must be implemented in a dynamically changing business environment.
- The Bank continuously monitors the operation of the established risk management systems and, if possible, subsequently measures the results and improves and ameliorates them on the basis of the experience gained.
- The Bank's management body with control powers approves, regularly reviews, and evaluates strategies and rules for segregation of responsibilities within the organisation, prevention of conflicts of interest, the taking, measurement, management, monitoring and evaluation of risks, including risks resulting from the macro-economic environment and changes in the current economic cycle.
- A part of the risk management strategy is the development of effective risk management processes.
- The risk management process is part of the Bank's comprehensive management system, the aspects of which play a role in strategic and annual planning.
- In any case, risk taking can only take place within the approved limit, in accordance with the guidelines of the Credit Policy.
- The Bank assumes only risks that can be measured and managed and that do not exceed its risk-bearing capacity. The risks are taken into account in the course of business decisions.
- The Bank focuses its risk-taking on business activities in which it possesses the necessary expertise and technical conditions for the assessment, measurement and monitoring of the risks entailed.
- The Bank's risk management policy includes the principle of safe operation, the principle of the avoidance of conflicts of interest, the principle of managing material risks, the cost-benefit principle, and the principle of avoiding prohibited activities.
- The Bank uses multi-level decision making in its lending decisions.
- Bank risks are determined on the basis of the ICAAP and the relevant EU Regulation.
- The Bank continuously monitors exposures and compliance with the limits at the level of the Credit Committee, the Asset-Liability Committee, the Board of Directors and the Supervisory Board as well. Risk management policy also involves a balance between the risk and return of positions and the continuously monitoring of it.
- The prior approval of the Asset-Liability Committee is required before the submission of the more important risk management rules/regulations detailed in the ELC Rules of Procedure to other bodies.
- The Bank also applies the four-eye principle when implementing risk-taking decisions to ensure compliance and fully conformity with the relevant policies.
- In order to reduce risks and capital requirements, the Bank only assumes any risks, depending on the creditworthiness of the customer and the risk structure of the transaction, if collateral or security of adequate quality (e.g. received guarantee, security deposit, government security collateral, surety, mortgage, etc.) is available.

37.3. Organisational units and functions that ensure the identification, measurement and monitoring of risks

The Bank has developed and operates its internal lines of defence, as well as each element that forms part of them, in accordance with the relevant legal requirements and the specificities, scope, complexity and risks of the service activities conducted by the Bank.

Accordingly, the Bank has developed and operates internal lines of defence that promote:

- the reliable and efficient operation of the Bank in accordance with laws and internal regulations,
- the protection of the Bank's assets, as well as the economic interests and social goals of its customers and owners,
- through these, the Bank's smooth and efficient operation and the preservation of trust towards the Bank.

The most important task of the Bank's internal lines of defence is to contribute preventively and proactively to the achievement of the above objectives by identifying and addressing potential problems and deficiencies that may arise during their operation at the earliest stage possible, as soon as they arise or possibly even before that, ensuring the speed and efficiency of a solution.
The Bank's internal lines of defence include the responsible internal management and internal control functions. The Bank ensures the implementation of responsible internal management by establishing and operating the organisational structure, organisation and system of bodies defined in its Organisational and Operational Rules, and by exercising management and control functions. The tools of the internal control functions are risk management functions, the compliance function and the internal audit system. The Bank's separate policies govern these tools, which are independent of each other and the functions they control.
The Asset-Liability Committee (ALC) regularly reviews the operation of internal lines of defence as well as the individual sub-systems that form part of them, and prepares a report of its findings regularly for the Board of Directors and the Supervisory Board.
Separate policies and rules of procedure govern the operation and interrelationship of all the Bank's decision-making bodies and organs (Board of Directors, Supervisory Board, Management Committee, Credit Committee, ALC, Problem Claims Committee), as well as Internal Audit and Compliance.
Overall, the lines of defence work effectively. Meetings of the Management Committee and the Asset-Liability Committee are held at least once a month, whereas the Credit Committee, the Board of Directors and the Supervisory Board meet at least quarterly. Any deficiencies that may arise are addressed by immediate measures.
Those responsible for Compliance and AML also perform their activities separately from operating and risk taking processes.

Risk Management function:
Risk Management is independent of the activities it supervises and controls, as well as from the Compliance function and Internal Audit.
The organisational framework of the process by which risk appetite can be established, the extent of the risks undertaken can be monitored and continuously maintained, has been set out within the risk strategy. The Bank does not limit risk management activities to the risk management area only, as being a company with a risk-conscious approach, the management of the Bank's risks is also the responsibility of its governing body, its management and employees alike.
As regards the Bank's growth, risk management areas have been separated, and a Risk Management Directorate and a Risk Management Methodology Directorate operate as independent risk management organisations under the supervision of the Chief Executive Officer.

The Risk Management Directorate is divided into the following departments:
- Corporate Credit Risk Management Department
- Retail Credit Risk Management Department

The Risk Management Methodology Directorate is divided into the following department(s):
- Market and Operational Risk Management

The independent control of the system and operation of risk management is primarily provided by the Asset-Liability Committee and its members, the competence of which is defined in detail in the relevant Rules of Procedure. Central risk control is implemented at the level of the Deputy CEO responsible for Finance and Operations.

Risk assumption activities are conducted by the Bank on the basis of a system of detailed written rules, and rules are reviewed by the Bank on an annual basis.

37.4. Mitigating and covering risks

The main principles of the policies pertaining to risk mitigation and credit risk coverage, the strategies and processes for risk mitigation and the control of the effectiveness of credit risk coverage tools, as well as the key aspects of the measurement of collateral, are set out in the Bank's Collateral measurement policy.
Principles:
The policy defines the proportion of collateral that the Bank assigns to various collateral types.
Methodology used to determine collateral value (depending on the type of collateral):

- Collaterals specified by law and 100% recognised: e.g. security deposits, state surety/guarantee.
- Collateral/liquidation value established by appraisers approved by the Bank. The policy sets out for the appraisers the system of requirements used for different types of collateral, as well as the minimum discount rate that can be applied.
- By discounting the value recorded in the guarantor's books, if the value cannot be established on the basis of the previous 2 methodologies.
- In the case of a surety/guarantee assumed by a third party for the claims of a debtor of the Bank, a value determined by using a discount rate adjusted to the third party's debtor rating.
- In the case of securities, a value determined by using discount rates taking into account the volatility of the exchange rate in accordance with the methodology set out in the policy.

The determination of the collateral value of a collateral is done in accordance with the methodology set out in the policy; in case appraisers approved by the Bank are employed, the collateral value determined by them is validated under the control of the risk manager.
The Bank reviews the collateral value of all collaterals with a frequency that is in accordance with prevailing legislation and internal regulations and, in the case of negative information, reviews it immediately after such information has arisen. The Bank verifies the existence of each collateral at least annually, and at least every six months in the case of certain collaterals.
The Bank also accepts collateral that does not meet the requirements for reducing the capital requirement (e.g. surety guarantees, specific pledges on an asset, warrants, etc.); however, only collateral that meets the requirements of Regulation 575/2013/EU is taken into account to reduce the capital requirement for credit risk.

37.5. Risk types relevant for the Bank, covered in Pillar I

a) Credit risk. In particular:
   - Risk of default concerning the loans granted by the Bank,
   - Partner risk,
   - Transfer risk,
   - Settlement risk.

The Bank calculates its capital requirement allocated for credit risk using a standard approach, and used the same method for the calculation in the past year as well.

b) Market risk
   - Trading book price rate risk.
   - Trading book interest rate risk.
   - Currency risk of the entire portfolio.

The monitoring of the market risk of the trading book by the use of appropriate IT systems, and the Bank fully complies with the legal requirements in the field of risk management.

c) Operational risk that includes all related risk sub-types defined by law (human, system, legal, external, etc.).

The Bank uses the basic indicator method for calculating the capital requirement for operational risk.

37.6. Principles and strategy for the ICAAP capital adequacy assessment process

Risk appetite, desired risk structure:

Risk appetite is the amount of risk an organisation is willing to take and can tolerate.

Aspects of the determination of risk appetite:
- what type and what degree of risk the Bank intends to take and the what return can be expected from it;
- whether the Bank has any comparative advantage in an area;
- what the capital requirement for actual risks is in the Bank,
- taking stock of all risks the Bank assumes, including the risks inherent in off-balance-sheet activities;
- risk assumption regularly reviewed and adjusted by the Bank on the basis of environmental, business, and risk information and analyses.

It is the responsibility of the governing body and the management of the Bank to define risk appetite and risk tolerance levels for the Bank's business and risk strategy.

The Bank builds up its loan portfolio in line with the asset-liability strategy, whereby it is a basic requirement that the borrower should repay the loan from its regular cash flow (cash-flow-based lending), of course still with the involvement of a maximum level of collateral to secure the loan. Non-preferred product: e.g. retail loans in foreign currencies.

Designating target variables and indicators:
It is a principle of the Bank's risk management policy is that the risk cost of the loan portfolio should not exceed 3.5% of the balance sheet total.

The Bank pursues a business policy that ensures that the Bank's capital adequacy ratio at all times exceeds the minimum capital requirements set out in Article 92 of Regulation (EU) No 575/2013 and complies with the provisions of the Credit Institutions Act on capital buffers (Hpt. Sections 86-96).

The Bank's Board of Directors, based on the medium-term strategy, adopts a detailed annual financial plan. In the framework of this, the Bank takes market information into account and conservatively assesses the proportion of default and risk costs of loans by corporate division and product class.
The composition and quality of the portfolio is monitored monthly by the Asset-Liability Committee. A quarterly report on the development of the results and the quality of the portfolio is made to the Board of Directors and the Supervisory Board. The Board of Directors and the Supervisory Board discuss and approve the reports and take the appropriate measures as necessary.

The Bank limits its risk appetite by setting limits. Compliance with this is monitored and regularly measured by the Bank in accordance with the limits established and defined in the internal regulations, employing the Management Information System developed by the Strategy and Analysis Directorate in accordance with internal regulations. This will ensure (even under stress conditions) that the set limits, risk indicators, etc. should be consistent with the Bank's risk appetite and risk tolerance.

Based on a risk map the Bank identified the risk factors relevant to it. The Bank needs to know its risk structure in detail, i.e. needs to know the proportion, concentration and significance of each type of risk in the portfolio. For this reason these are continuously monitored by Risk Management together with the strategic area. The Bank currently considers credit risk to be its most important type of risk.

Responsibilities and duties are set out in detail in the Bank's internal policies.

Risk types covered in Pillar II

- Credit concentration risk
- Country risk
- Interest rate risk in the banking book
- Foreign currency risk
- Liquidity risk
- Settlement risk
- Operational, reputational and strategic Risk

The risk management concept and order of each risk type are set out in separate policies.

37.7. Credit risk

The Bank pays special attention to the fact that customers should be able to repay the loan from their regular income, but at the same time in order to protect deposit owners, it applies a wide range of collaterals as an adequate protection against credit risk. The high quality of the portfolio is the joint result of a thorough risk management analysis work conducted prior to decision making, the decision-making mechanism (pre-screening, risk analysis, decision by, depending on the amount, of the Lending Committee or of the Board of Directors), the application of a wide range of collaterals, and strict credit monitoring.

a. *The Bank determines the credit risk (limit) of customers/customer groups on the basis of strict procedures, by individual decisions in the following structure:*

Types of risk assumption limits

- Credit limit: for all loans and credit substitute products
- Guarantee limit: for guarantees in a narrower sense, letters of credit, bill broker transactions, and similar transactions in which the Bank commits to fulfil an obligation of the debtor,
- Substitution limit (pre-settlement): for foreign exchange transactions, derivatives, forward rate agreements, repo transactions, securities-based loans, etc.
- Settlement limit: the risk arising from the execution and clearing of trading products,
- Issuer limit: includes debtor and issuer risks shown in the trading or investment book.

The sum of the above limits is the gross aggregate limit.
In all cases, the prerequisite for entering into risk assumption transactions is prior approval by the body having decision-making power in accordance with the effective regulations, and by the retail business and risk management manager in the case of standard retail overdrafts.
Limit monitoring is based on the daily closing balance. There is a separate internal policy for dealing with limit overruns, which includes the obligation of immediate reporting.

b. The threshold of the maximum credit risk that can be assumed concerning each customer/customer group is determined by the approved limits, which take into account the Bank's current high-risk assumption limit.

c. Causal (industry) concentration means the risk of concurrent default attributable to the same common cause or causes.

The role of industry limits is to control the magnitude of the risks assumed by the Bank and to mitigate the Bank's risk-taking in sectors that pose a higher risk.
The Bank defines limits for the corporate portfolio concerning each industry of the national economy.
The Bank also applies product limits to retail mortgage loans and overdrafts, as well as to the refinancing of Lombard credit and the NFA's "land for farmers" programme.

d) *The country limit* limits the amount of all risks that can be assumed *regarding a particular country*, i.e. the given government itself, any party entering into an agreement with the Bank or risk-bearing party incorporated in the given country, the citizens of the foreign state and any other economic entity that belongs under the jurisdiction of that foreign state for any other reason.

Country risk also includes the cases where the recovery of a receivable or receivables from a particular customer depends on income from a foreign country. If several criteria are at play, the transaction is to be charged against the limit of the country with the lower rating.

37.8. Customer and transaction rating, determination of expected credit loss

I. Schedule of ratings

I.1 Quarterly rating:

The Bank performs the rating of transactions for its exposures subject to IFRS 9 at least once per calendar quarter, for the last day of the quarter. The aim of the quarterly transaction rating is to classify the exposures in accordance with the MNB's requirements and the requirements of IFRS 9, and to recognise or reverse the impairment and the provision for the transaction rating in accordance with the relevant segment methodology.

I.2. Extraordinary rating:

In the intervals between quarterly ratings, an extraordinary rating must be performed for individual exposures in the case when during the processing of the information received by any of the Bank's organisational units, a level of risk is detected with a receivable or off-balance sheet liability that necessitates the recognition of a loss significantly higher than the impairment or provision recorded in the books, and/or the exposure must be reclassified into the non-performing and/or restructured category.

II. Measurement of the expected credit loss

When measuring expected credit losses, the Bank does not necessarily identify all possible scenarios, but takes into account the risk or likelihood of a credit loss occurring by calculating with both the likelihood of the occurrence and of the non-occurrence of the credit loss, even if the likelihood of the occurrence of the credit loss is very low. In practice this means that the Bank:

- For financial assets whose repayment if based on a schedule, if individually assessed in the context of a unique scenario analysis for estimating expected credit losses, in addition to the original scenario included in the agreement, it examines two more scenarios, assigning likelihoods to their occurrence and then employing the DCF method to calculate the amount of the required impairment.
- For financial assets were the expected credit loss is estimated on the basis of collective principles – on the basis of the PD*LGD*EAD formula – rather than by outlining individual cash flow scenarios, it incorporates the probability of the various scenarios into its model during the determination of the PD value and thus calculates the amount of the required impairment.

III. Exposure portfolios for transaction rating

In order to estimate the impairment or provisioning as accurately as possible, the Bank identified the following exposure portfolios from its current portfolio. Each portfolio adequately aggregates transactions that have characteristics similar to each other, so each portfolio is internally sufficiently homogeneous while being sufficiently different from each other so that the rating indicators that form the basis for impairment and provisioning, and their relative weight, can be calibrated separately for each portfolio in order to reach a more accurate estimate.

(a) Retail customers
   - private individuals
   - primary producers
   - sole traders

(b) Non-retail customers
   - Companies (non-financial corporations)
   - Project companies (special lending exposures)

- Other financial corporations (e.g. leasing companies, factoring companies)
- Other non-profit companies
- Local municipalities
- Credit institutions (financial institutions)
- Government/State

(c) Other receivables (fee claims)
(d) Off-balance-sheet liabilities

IV. Transaction rating categories under IFRS 9 (with a different term: baskets)
As a first step in determining the expected credit loss of its financial instruments, the Bank classifies its financial instruments into one of three transaction rating categories (valuation baskets).

(a) Basket 1 – Well-performing financial instruments

Basically, this basket includes the financial instruments that the Bank considers to be performing well, as their credit risk is typically low or has not significantly increased compared to the initial recognition.

(b) Basket 2 – Underperforming financial instruments

This basket includes financial instruments whose credit risk has increased significantly since the initial recognition, but which have not yet reached non-performing status.

The following are considered to be a significant increase in credit risk:

- Delay of more than 30 days (the assumption can be refuted)
- A deterioration of 4 categories compared to the initial recognition on the master scale, in the case of segments evaluated using the master scale
- The deterioration 3 categories in customer rating compared to the initial recognition in the case of financial institutions and the government and municipal segments
- Restructuring of a risk assumption agreement
- "Problematic" classification as described in the policy for problematic transactions (to be considered carefully)
- In the case of retail mortgage loans, a significant increase of over 95% of the loan-to-value ratio compared to that the time of the disbursement
- In the case of speculative property financing project loans, indicators specified in recommendation 12/2018. (II.27.) of the MNB
- Special circumstances indicating the need for a lifetime assessment

(c) Basket 3 – Non-performing (defaulted) financial instruments

This basket includes only the financial instruments that are non-performing (defaulted), classified in the 17th, i.e. last, category ("default") of the Bank's 17-grade credit loss master scale, and those that have been overdue for more than 90 days and the part affected by the delay is significant, as well as those classified by the Bank as non-performing according to other criteria specified in the relevant policy.
The real difference between the classification into the three classification categories (baskets) under IFRS 9 is not the individual or collective methodology used for measuring the expected credit loss, or the absolute value of the loss, but rather the relative magnitude of the change in the credit risk, and the fact that

- the expected credit loss is calculated by the Bank on the basis of the 12-month default risk in Basket 1, whereas in Baskets 2 and 3 the Bank bases its calculation on the lifetime default risk (except for bullet/balloon type transactions where the Bank determines the rate of the expected loss on the basis of the lifetime default risk in basket 1 as well, given that in the case of such transactions the default pattern is concentrated over the period beyond the next 12 months), and

- The Bank calculates the interest income on the basis of the gross amortised cost (excluding impairment) in the case of transactions in Basket 1 and Basket 2, and on the net amortised cost (including impairment) in the case of transactions in Basket 3.

V. Overview of the measurement methods used by the Bank

The Bank measures and recognises impairment/provisions in accordance with the rules of IFRS 9 as follows.

V.1. Simplified collective measurement method

The Bank applies the collective measurement method in the case of other receivables (receivables from financial and investment services, typically fees).
Other receivables are receivables from financial and investment services, typically without collateral, which the Bank classifies into the transaction rating baskets set out in the MNB Decree using a simplified rating based on the number of days in delay.
Under the simplified collective measurement method, the Bank determines the amount of impairment on the basis of a predetermined fixed percentage applied to the exposure outstanding on the date of the measurement.

V.2. Individual measurement method

- includes *the PD * LGD * EAD method that shows collective characteristics but is based on individual data, and*
- the *discounted cash flow method based on individual cash flow estimates* ("DCF method").

The Bank applies the individual DCF method to its exposures exceeding HUF 500 million (subject to certain exceptions set out in the relevant policy), based on expert analysis; while impairment/provision is primarily calculated for exposures below HUF 500 million on the basis of the method with collective characteristics, taking into consideration PD, LGD and other correction factors estimated on a statistical basis in Basket 1 and Basket 2, while the Bank uses the DCF model in Basket 3.

V.2.1. Individual measurement model with collective characteristics

As a general rule, the Bank calculates impairment loss on the basis of indicators developed for the estimation of Expected Loss ("EL"), i.e. Probability of Default (PD), Exposure at Default ("EAD") and Loss Given Default ("LGD"). The method used to determine exposure at default depends on whether the item is on-balance-sheet or off-balance-sheet.

(a) In the case of an on-balance-sheet item, "EAD", i.e. the exposure at default means, for the purpose of simplification, the book exposure of that item at the reporting date.
(b) For off-balance-sheet items, "EAD" must first be determined using a credit conversion factor ("CCF"), which is the probability of an exposure ("E") being included in the balance sheet or not.

The Bank establishes the credit conversion factor (equivalent) pursuant to Regulation (EU) No. 575/2013 of the European Parliament (CRD IV), according to a standard method.
Based on the above, the Bank, as a general rule, establishes the expected credit loss using the following formula:

$$EL = PD \times LGD \times EAD \times CCF$$

The calculations are made in accordance with the requirements of IFRS9 using the point in time estimation method, applied in the macroeconomic correction component of PD.

V.2.2. Individual impairment establishment method based on the cash-flow stress model

In addition to the impairment model used as a general rule, the Bank may also use a purely individual measurement model that determines the expected credit loss of a given individually measured transaction using the discounted cash flows ("DCF") method based on CF scenarios developed by an expert.
To establish the basis of the individual impairment established using the DCF method, the credit risk manager of the given loan, in addition to the original contractual cash-flow scenario, based on their best knowledge of the customer and the given transaction develops at least two more potential cash-flow scenarios, where at least one of these is expected to be based on the assumption that the transaction becomes non-performing. The credit risk manager assigns probabilities to the two or more cash flow stress scenarios.

VI. Combined transaction rating (credit risk master scale)

The Bank, combining
(a) its own regularly monitored and updated customer rating categories based on historical data, and
(b) its scoring system for the behaviour of a particular customer concerning a specific transaction ("behavioural scoring"), which also includes forward-looking information,

has created a 17-grade master scale in order to measure credit risk changes for the following segments:

- Retail segment
- Corporate segment
- Other financial corporate segment
- Project loans segment
- Non-profit segment

The 17-grade master scale shows the increase in credit risk from category 1, the lowest credit risk, up to 17, the highest credit risk category characterised by non-performance.
This master scale evaluates the Bank's transactions in a particular portfolio based on a complex set of criteria that not only take into account past data of the particular customer and transaction, but also consider several pieces of forward-looking information based on the customer's transaction behaviour. Based on the master scale, the Bank also adjusts the PD calculated for each transaction by incorporating macroeconomic indicators. Such a complex credit risk monitoring system enables the Bank to detect an increase in credit risk before the particular transaction becomes overdue. As a result, a transaction with a significantly increased credit risk is classified into a transaction rating category (impairment/provisioning basket) where the impairment/provision calculation is based on a lifetime estimate of the expected credit loss.
The Bank has developed various behavioural point systems for its customer portfolios with significantly different characteristics. These behavioural point systems examine different characteristic behavioural elements concerning transactions under a particular customer portfolio, thereby allowing the transactions belonging to each customer portfolio to be classified to the appropriate level of the single master scale on the basis of the Bank's customer rating/debtor rating and their most typical behavioural patterns during the combined transaction rating process.
The Bank relies on the available ratings of external rating agencies to determine the probability of default concerning the government, municipal and banking segments.

VII. Macroeconomic adjustment of the PD calibration

In order to ensure that the probability of default (PD) is forward-looking, the Bank monitors only external macroeconomic indicators and adjusts the PD values determined for each transaction by the effect of these. Also in line with the MNB's circular of 25 June 2018, the Bank uses the macroeconomic forecasts published in the MNB's Inflation Report. Macroeconomic indicators established in a different way for each portfolio segment include:

- Gross Domestic Product (GDP) volume indices – seasonally and calendar-adjusted and balanced data (previous quarter = 100.0%),
- Customer price index,
- Employment rate.

VIII. LGD calibration

The value of loss given default (LGD) is the difference between the book value of the exposure at the time of default and the amount of collateral that the Bank is expected to be able to use. The Bank determines the value of the collateral that is expected to be available on the basis of a general discount predetermined for each type of collateral, based on the market value of the collateral. The Bank determined the general discount to be used with the market value by collateral type by using external expert estimates.

IX. Restructured loans

The Bank has detailed regulations that set forth the rules of restructuring as follows:

(1) The Bank treats all loans, acquired receivables or any other receivables arising from transactions classified as money lending or from other financial services, if containing a discount and granted to the debtor, obligor (hereinafter collectively referred to as the obligor or the customer) at the request of the obligor or the Bank, as restructured receivables. In addition, restructured receivables include commitments related to lending that may become receivables at the customer's discretion (collectively: receivables) if the discount was granted to an obligor that has or is expected to have financial difficulties in meeting its financial obligations.
(2) The Bank recognises receivables as restructured receivables that include a discount and where the original agreement that gave rise to the receivable has been amended to avoid non-payment because the debtor is or, in the absence of the discount, would be unable to meet its repayment obligation under the original contractual terms.
(3) In the absence of information to the contrary, it may be assumed that the debtor has no financial difficulties if the debtor has not had a payment delay of more than 30 days in respect of any of its liabilities to the Bank within 90 days prior to the conclusion or the amendment of the contract.

X. Spreadsheet data relating to credit risk

Customer portfolio by industry

The following table shows the net portfolio of customer loans broken down by industry on 31 December 2019 and at the end of the comparative year.
Data in HUF millions

Sector	**31.12.2019**	**31.12.2018**
Agriculture, forestry, fishing	3,008	2,317
Mining, mining services	42	53
Manufacturing	16,376	14,431
Electricity, gas, steam supply, air conditioning	4,751	6,143
Water supply, waste water collection and treatment, waste management, decontamination	534	115
Construction	3,522	2,647
Trade, vehicle repair	9,787	8,626
Transportation, warehousing	2,348	171
Accommodation and food service activities	1,754	1,617
Information and communication	2,308	2,402
Financial and insurance activities*	34,632	26,249
Real estate	43,497	38,643

Sector	31.12.2019	31.12.2018
Professional and scientific activities, administrative and service support activities	2,708	2,799
Other activities	2,307	2,351
Household/Retail	19,588	14,308
Unknown industry	12,837	13,266
Public administration and defence, compulsory social security	721	1,049
Training	102	121
Human health services and social work activities	1,525	1,055
Arts, entertainment and recreation	1,369	2,124
Other services	1,989	1,962
Total	**165,705**	**142,449**

Breakdown of customer portfolio by rating

The following table shows the breakdown of customer loans by internal rating categories (master scale rating).

Data in HUF millions

		31.12.2019		31.12.2018	
	Internal rating	**Gross exposure**	**Impairment**	**Gross exposure**	**Impairment**
Retail segment	1-4	15	0	28	0
	5-8	13,914	0	11,774	1
	9-12	939	0	2,474	0
	13-16	1,179	3	17	1
		16,047	**3**	**14,293**	**2**
Corporate segment	1-4	47	0	1,997	0
	5-8	60,820	18	66,407	38
	9-12	4,638	1	671	1
	13-16	48	0	0	0
		65,553	**19**	**69,075**	**39**
Other financial corporate segment	1-4	8,808	0	3,091	0
	5-8	3,090	1	4,262	2
	9-12	0	0	0	0
	13-16	0	0	0	0
		11,898	**1**	**7,353**	**2**
Project loans	1-4	2,168	0	2,330	0
	5-8	38,709	3	36,282	4
	9-12	54	0	0	0
	13-16	95	64	402	63
		41,026	**67**	**39,014**	**67**
Non-profit segment	1-4	0	0	0	0
	5-8	858	1	411	1
	9-12	0	0	0	0
	13-16	0	0	0	0
		858	**1**	**411**	**1**
		135,382	**90**	**130,145**	**111**

		31.12.2019		31.12.2018	
	Internal rating	**Undrawn lines**	**Provision**	**Undrawn lines**	**Provision**
Retail segment	1-4	0	0	0	0
	5-8	73	0	206	0
	9-12	72	0	3	0
	13-16	0	0	0	0
		145	**0**	**209**	**0**
Corporate segment	1-4	0	0	5,000	0
	5-8	11,547	5	9,489	12
	9-12	3,619	11	467	5
	13-16	0	0	0	0
		15,166	**16**	**14,956**	**17**
Other financial corporate segment	1-4	1,015	0	360	0
	5-8	7	0	42	0
	9-12	0	0	0	0
	13-16	0	0	0	0
		1,022	**0**	**402**	**0**
Project loans	1-4	0	0	904	0
	5-8	4,793	1	4,902	0
	9-12	0	0	0	0
	13-16	0	0	0	0
		4,793	**1**	**5,806**	**0**
Non-profit segment	1-4	0	0	0	0
	5-8	190	0	0	0
	9-12	0	0	160	1
	13-16	0	0	0	0
		190	**0**	**160**	**1**
		21,316	**17**	**21,533**	**18**

The above tables do not include loans granted to ESOP members, the amount of which was HUF 1,365 million as of 31.12.2019 (HUF 1,365 million as of 31.12.2018), which, due to their closed construction, are not classified into rating categories by Bank Group and do not entail impairment.

Customer portfolio coverage

The following table shows the market value of collateral related to the segments of the loan portfolio as of 31.12.2019 and 31.12.2018.

Data in HUF millions

	31.12.2019			31.12.2018		
	Net exposure	**Collateral**	**Not covered**	**Net exposure**	**Collateral**	**Not covered**
Retail segment	16,044	26,564	0	14,290	21,368	0

Corporate segment	65,535	158,955	0	67,102	140,094	0
Other financial corporate segment	11,897	12,465	0	7,351	6,184	1,167
Project loans	40,960	107,036	0	38,947	102,557	0
Local municipalities	1,823	0	1,823	2,357	0	2,357
Non-profit segment	857	1,391	0	410	586	0
Bank segment	0	0	0	0	0	0
State segment	4,352	0	4,352	1,932	0	1,932
Total	**141,468**	**306,411**	**6,175**	**132,390**	**270,789**	**5,456**

Exposures and their collaterals classified in basket 3

Data in HUF millions

	Gross exposure	Collateral
31.12.2019	175	1,050
31.12.2018	420	744

Collaterals by segment by type of collateral

Data in HUF millions

Collateral type	**31.12.2019**	**31.12.2018**
Retail segment		
Guarantee	8	12
Property	10,674	9,080
Suretyship	2	2
Deposit / Cash / Hungarian government securities / Other security deposit	15,665	11,625
Miscellaneous	639	649
Retail segment total	**26,988**	**21,368**
Corporate segment		
Guarantee	3,566	3,403
Property	38,529	29,179
Suretyship	16,762	16,204
Deposit / Cash / Hungarian government securities / Other security deposit	31,501	39,784
Miscellaneous	68,509	51,524
Corporate segment total	**158,867**	**140,094**
Other financial corporate segment		
Guarantee	4,649	483
Property	79	79
Suretyship	423	519
Deposit / Cash / Hungarian government securities / Other security deposit	4,553	3,200
Miscellaneous	2,761	1,903
Other financial corporate segment total	**12,465**	**6,184**
Project loans		
Guarantee	5,118	3,648
Property	72,690	68,542
Suretyship	5,274	6,363
Deposit / Cash / Hungarian government securities / Other security deposit	10,161	6,693

Miscellaneous	13,908	17,311
Project loans total	**107,151**	**102,557**
Non-profit segment		
Guarantee	0	0
Property	670	0
Suretyship	192	162
Deposit / Cash / Hungarian government securities / Other security deposit	10	0
Miscellaneous	519	424
Non-profit segment total	**1,391**	**586**
Grand total	**306,862**	**270,789**

Due to their special closed construction, the table does not contain the loans granted by the ESOP. Receivables are covered by shares purchased from loans granted under the plan.

Movements between FRS 9 baskets

Data in HUF millions

2019 Basket classification at the beginning/end of year	**Basket 1**	**Basket 2**	**Basket 3**	**Derecognised during the period**	**Total**
Impairment					
31.12.2018	**49**	**0**	**64**		**113**
Created during the period	11	0	0		
Basket 1	-30	0	0	-4	
Basket 2	0	0	0	0	
Basket 3	0	0	0	0	
31.12.2019	**30**	**0**	**64**	**-4**	**90**
Provision					
31.12.2018	**18**	**0**	**0**		**18**
Created during the period	12	3	0		
Basket 1	-12	0	0	-3	
Basket 2	0	0	0	0	
Basket 3	0	0	0	0	
31.12.2019	**18**	**3**	**0**	**-3**	**18**

2018 Basket classification at the beginning/end of year	**Basket 1**	**Basket 2**	**Basket 3**	**Derecognised during the period**	**Total**
Impairment					
31.12.2017	**42**	**1**	**1**		**44**
Created during the period	24	0	1		
Basket 1	-2	0	64	-17	
Basket 2	-1	0	0	0	
Basket 3	0	0	0	0	

31.12.2018	**63**	**1**	**66**	**-17**	**113**
Provision					
31.12.2017	**7**	**0**	**0**		**7**
Created during the period	16	0	0		
Basket 1	-2	-1	0	-2	
Basket 2	0	0	0	0	
Basket 3	0	0	0	0	
31.12.2018	**21**	**-1**	**0**	**-2**	**18**

In the case of loans granted under the ESOP, the Bank Group does not use the basket classification, so they are not included in the table above.

Restructured transactions

As at 31.12.2018, the Bank has two restructured retail loans; the amount of the exposure is not significant. As at 31.12.2018, the Bank had two restructured retail transactions on its books; the amount of the exposure is not significant.

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Impairment movement board
Data in HUF millions

	Impairment					Gross exposure				
Basket 1	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**
Customer loans measured at amortised cost										
Retail segment	0	0	0	0	0	14,159	3,479	-266	-1,521	15,851
Corporate segment	41	7	-26	-3	19	69,074	12,461	-2,570	-11,793	67,172
Other financial corporate segment	2	0	-1	0	1	7,354	6,809	-974	-1,290	11,899
Project loans	4	2	-1	0	5	38,611	6,978	-508	-4,151	40,930
Local municipalities	1	0	0	0	1	2,358	-231	-305	0	1,822
Non-profit segment	0	1	-1	0	0	411	605	-158	0	858
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	2,421	0	0	2,421
Total customer loans measured at amortised cost	**48**	**10**	**-29**	**-3**	**26**	**131,967**	**32,522**	**-4,781**	**-18,755**	**140,953**
Securities measured at amortised cost										
State segment	0	0	-1	0	-1	5,134	0	-388	-476	4,270
Total securities measured at amortised cost	**0**	**0**	**-1**	**0**	**-1**	**5,134**	**0**	**-388**	**-476**	**4,270**
Securities measured at fair value through other comprehensive income										
Bank segment	0	0	0	0	0	1,434	0	0	88	1,522
State segment	1	1	0	-1	1	7,877	7,098	0	-7,833	7,142

	Impairment					Gross exposure				
Basket 1	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**
Total securities measured at fair value through other comprehensive income	**1**	**1**	**0**	**-1**	**1**	**9,311**	**7,098**	**0**	**-7,745**	**8,664**
Interbank placements										
Interbank placements	0	0	0	0	0	41,271	35,972	0	-41,271	35,972
Total interbank placements	**0**	**0**	**0**	**0**	**0**	**41,271**	**35,972**	**0**	**-41,271**	**35,972**
Basket 1 total	**49**	**11**	**-30**	**-4**	**26**	**187,683**	**75,592**	**-5,169**	**-68,247**	**189,859**

Basket 2	Impairment Opening – 01.01.2019	Impairment Created	Impairment Credit risk change	Impairment Derecognition	Impairment Closing – 31.12.2019	Gross exposure Opening – 01.01.2019	Gross exposure Created	Gross exposure Credit risk change	Gross exposure Derecognition	Gross exposure Closing – 31.12.2019
Customer loans measured at amortised cost										
Retail segment	0	0	0	0	0	116	0	80	-1	195
Corporate segment	0	0	0	0	0	0	55	260	0	315
Other financial corporate segment	0	0	0	0	0	0	0	0	0	0
Project loans	0	0	0	0	0	0	0	0	0	0
Local municipalities	0	0	0	0	0	0	0	0	0	0
Non-profit segment	0	0	0	0	0	0	0	0	0	0
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	0	0	0	0
Total customer loans measured at amortised cost	**0**	**0**	**0**	**0**	**0**	**116**	**55**	**340**	**-1**	**510**
Securities measured at amortised cost										
State segment	0	0	0	0	0	0	0	0	0	0
Total securities measured at amortised cost	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Securities measured at fair value through other comprehensive income										
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	0	0	0	0
Total securities measured at fair value through other comprehensive income	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Interbank placements										
Interbank placements	0	0	0	0	0	0	0	0	0	0
Total interbank placements	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Basket 2 total	**0**	**0**	**0**	**0**	**0**	**116**	**55**	**340**	**-1**	**510**

Basket 3	Impairment Opening – 01.01.2019	Impairment Created	Impairment Credit risk change	Impairment Derecognition	Impairment Closing – 31.12.2019	Gross exposure Opening – 01.01.2019	Gross exposure Created	Gross exposure Credit risk change	Gross exposure Derecognition	Gross exposure Closing – 31.12.2019
Customer loans measured at amortised cost										
Retail segment	1	0	0	0	1	17	0	-16	0	1
Corporate segment	0	0	0	0	0	0	0	0	0	0
Other financial corporate segment	0	0	0	0	0	0	0	0	0	0
Project loans	63	0	0	0	63	402	0	-307	0	95
Local municipalities	0	0	0	0	0	0	0	0	0	0
Non-profit segment	0	0	0	0	0	0	0	0	0	0
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	0	0	0	0
Total customer loans measured at amortised cost	**64**	**0**	**0**	**0**	**64**	**419**	**0**	**-323**	**0**	**96**
Securities measured at amortised cost										
State segment	0	0	0	0	0	0	0	0	0	0
Total securities measured at amortised cost	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Securities measured at fair value through other comprehensive income										
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	0	0	0	0
Total securities measured at fair value through other comprehensive income	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Interbank placements										
Interbank placements	0	0	0	0	0	0	0	0	0	0
Total interbank placements	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Basket 3 total	**64**	**0**	**0**	**0**	**64**	**419**	**0**	**-323**	**0**	**96**

	Impairment					Gross exposure				
Basket 3	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**
Total	**113**	**11**	**-30**	**-4**	**90**	**188,218**	**75,647**	**-5,152**	**-68,248**	**190,465**

Basket 1	Provision: Opening – 01.01.2019	Provision: Created	Provision: Credit risk change	Provision: Derecognition	Provision: Closing – 31.12.2019	Undrawn line: Opening – 01.01.2019	Undrawn line: Created	Undrawn line: Credit risk change	Undrawn line: Derecognition	Undrawn line: Closing – 31.12.2019
Customer loans measured at amortised cost										
Retail segment	0	0	0	0	0	142	29	-1	-29	141
Corporate segment	17	1	-1	-3	14	14,741	203	-309	-21	14,614
Other financial corporate segment	0	0	0	0	0	402	661	-40	0	1,023
Project loans	0	1	0	0	1	5,806	3,981	-4,110	-885	4,792
Local municipalities	0	0	0	0	0	1,195	-1,195	0	0	0
Non-profit segment	1	-1	0	0	0	160	30	0	0	190
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	9,967	0	0	9,967
Total customer loans measured at amortised cost	**18**	**1**	**-1**	**-3**	**15**	**22,446**	**13,676**	**-4,460**	**-935**	**30,727**
Basket 1 total	**18**	**1**	**-1**	**-3**	**15**	**22,446**	**13,676**	**-4,460**	**-935**	**30,727**

	Provision					Undrawn line				
Basket 2	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**	**Opening – 01.01.2019**	**Created**	**Credit risk change**	**Derecognition**	**Closing – 31.12.2019**
Customer loans measured at amortised cost										
Retail segment	0	0	0	0	0	68	6	-68	0	6
Corporate segment	0	3	0	0	3	214	335	0	0	549
Other financial corporate segment	0	0	0	0	0	0	0	0	0	0
Project loans	0	0	0	0	0	0	0	0	0	0
Local municipalities	0	0	0	0	0	0	0	0	0	0
Non-profit segment	0	0	0	0	0	0	0	0	0	0
Bank segment	0	0	0	0	0	0	0	0	0	0
State segment	0	0	0	0	0	0	0	0	0	0
Total customer loans measured at amortised cost	**0**	**3**	**0**	**0**	**3**	**282**	**341**	**-68**	**0**	**555**
Basket 2 total	**0**	**3**	**0**	**0**	**3**	**282**	**341**	**-68**	**0**	**555**
Total	**18**	**4**	**-1**	**-3**	**18**	**22,728**	**14,017**	**-4,528**	**-935**	**31,282**

37.9. Market risk

The Bank confines its market price risks, in particular foreign exchange, interest rate and security exposures, with an appropriate internal and external targeted limit system. At present, the Treasury's own-account trading is largely related to liquidity management and the fulfilment and coverage of customer needs.
Partner and customer limits are set for the Treasury's partners, which are recorded in the Treasury's front office system (Inforex). The Bank mitigates its risks concerning major customers through netting and margin (ISDA, CSA, GMRA) agreements.
Any market risks resulting from trading book exposures have been limited in scope, and the thresholds have been respected – trading was mostly done in government securities and discount treasury bills. The Bank also had stock-exchange listed equity positions, which were not in the trading book as at the end of the year, since they are to be held and not sold. The Bank does not trade in non-linear interest rate derivatives or commodities.

Interest rate risk

The Bank considers the management of interest rate risk in the banking book (IRRBB) to be of high importance, and, via Interbank Transactions (IRS, CCIRS), replaces its major fixed-rate assets with variable-rate assets that are adjusted to the liabilities.
Interest rate risk typically arises from the fact that the repricing period and maturity of asset and liability items are different.
Under Pillar 2, the Bank determines the capital requirement for the interest rate risk of the Bank Book by interest rate sensitivity stress calculations based on the time remaining until repricing, taking into account the individual cash flow elements (assets, liabilities) of all transactions as well as their gap values and indicators by band, which examine the expected change in the Bank's economic value of equity ("EVE") and in annual expected net interest income ("NII") as a function of changes in yield levels. During the modelling process, in the case of loans, the Bank takes into account the results of the impairment model, applies a conservative model to delays in the repricing of instant-access deposits, and models the options for legal and embedded negative interest rates. In the past year, the Bank significantly expanded its stress tests, followed the expansion of supervisory recommendations ("standard" tests) and introduced its own stress tests as well. The most important of these are presented below.

Stress tests performed:

Number	Scenario	Type	Method
0	Basic scenario without a shift		Evaluation with the current yield curve without a shift
1	Parallel_UP	standard	Parallel yield upshift
2	Parallel_DOWN	standard	Parallel yield downshift
3	Steepening	standard	short-term yields fall, long-term yields rise
4	Flattening	standard	short-term yields rise, long-term yields fall
7	Long_UP	Gránit Bank requirement	long-term yields rise
8	Long_DOWN	Gránit Bank requirement	long-term yields fall
11	Parallel_UP_Dinamic	Gránit Bank requirement	Parallel yield upshift, taking into account the effects of portfolio changes
12	Parallel_DOWN_Dinamic	Gránit Bank requirement	Parallel yield downshift, taking into account the effects of portfolio changes
15	Paralell_UP_OLD_STANDARD	For the Supervisory Limit	200 parallel upshift

16	Paralell_DOWN_OLD_STANDARD	For the Supervisory Limit	200 parallel upshift

Stress measures by currency:

CCY	Type	Base scenario	Shift in base points	CCY	Type	Base scenario	Shift in base points
HUF	standard	Parallel +/-	250	CHF	standard	Parallel +/-	100
HUF	standard	Short +/-	350	CHF	standard	Short +/-	150
HUF		Long +/-	160	CHF		Long +/-	100
EUR	standard	Parallel +/-	200	GBP	standard	Parallel +/-	250
EUR	standard	Short +/-	250	GBP	standard	Short +/-	300
USD	standard	Short +/-	300	JPY	standard	Short +/-	100
USD		Long +/-	150	JPY		Long +/-	100
All	"old standard"	Parallel +/-	200				

The Bank quantifies the interest rate risk, checks compliance with the limit and presents it to the Assets and Liabilities Committee on a monthly basis.
Given its activities, the Bank's reference interest rate risks are not significant.

Highlighted stress test results at the end of 2019:

			Results by currency (in HUF)			
Reference no.	Scenario	Type	Total	HUF	EUR	USD
EVE - 1	Parallel_UP	standard	-1,067,765,511	-1,033,397,919	-34,482,851	115,259
EVE - 2	Parallel_DOWN	standard	786,453,112	776,815,085	9,756,697	-118,670
EVE - 3	Steepening	standard	-82,156,211	-86,775,543	4,711,998	-92,665
EVE - 4	Flattening	standard	-142,193,833	-126,710,052	-15,599,898	116,117
EVE - 5	Short_UP	standard	-539,546,092	-514,808,207	-24,889,883	151,997
EVE - 6	Short_DOWN	standard	415,807,472	404,338,351	11,639,497	-170,376
EVE - 9	Sensitivity_UP	Gránit Bank requirement	-448,675,377	-431,229,852	-17,503,571	58,046
EVE - 10	Sensitivity_DOWN	Gránit Bank requirement	484,966,810	475,269,011	9,756,697	-58,898
EVE - 15	Paralell_UP_OLD_STANDARD	For the Supervisory Limit	-873,546,629	-839,179,037	-34,482,851	115,259
EVE - 16	Paralell_DOWN_OLD_STANDARD	For the Supervisory Limit	948,710,342	912,222,327	36,606,686	-118,670
NII - 1	Parallel_UP	standard	-324,974,161	-352,583,677	31,829,964	-4,220,448
NII - 2	Parallel_DOWN	standard	475,944,577	480,792,619	-9,068,490	4,220,448
NII - 3	Steepening	standard	475,815,406	480,792,619	-9,068,490	4,091,277
NII - 4	Flattening	standard	-392,701,690	-417,144,433	29,483,621	-5,040,878
NII - 5	Short_UP	standard	-483,107,056	-514,329,249	37,531,356	-6,309,163
NII - 6	Short_DOWN	standard	476,785,128	480,792,619	-9,068,490	5,060,999
NII - 9	Sensitivity_UP	Gránit Bank requirement	-127,228,713	-141,033,471	15,914,982	-2,110,224
NII - 10	Sensitivity_DOWN	Gránit Bank requirement	450,229,178	457,187,444	-9,068,490	2,110,224

Main Interest Rate Sensitivity Indicators according to the methodology used at the end of 2018 and before

100 bp

	Impact in million HUF
Currency	**2018**
HUF	-220
EUR	-47
Total	-180

100 bp

	Impact in million HUF
Currency	**2018**
HUF	557
EUR	-130
Total	427

HUF 220 bp, Other: 200 bp.

	Impact in million HUF
Currency	**2018**
HUF	1,158
EUR	-252
Total	901

1 bp

		Impact in million HUF
	2019	**2018**
Total sensitivity	0.869	43.45

Currency risk

The Bank does not have any significant open foreign exchange positions, and the Treasury continuously monitors the risk coverage needs.

The additional Pillar 2 capital requirement of foreign exchange positions is quantified using the standardised VaR calculator required by the Regulator, also taking into account the Regulator's relevant recommendation. The capital requirement for foreign exchange risk is, in line with the net positions, not significant. VaR is by definition the estimated amount of money that can be lost on a given portfolio due to market risk over a specified period and at a given confidence level. This measurement takes into account the market risk associated with the current portfolio. During 2019, the Bank also introduced the stressed value-at-risk (SVaR) method for calculating currency risk. The total currency risk capital requirement is determined by the higher of the two measures. The essence of the SVaR calculation is that a correlation matrix reflecting high volatilities caused by a former market crisis period is used. Pillar

2 parametric VaR calculation results at a confidence level of 99% and with a 10-day retention period are as follows:

Value at Risk calculation for the Bank's total foreign exchange risk

Confidence level:	99%
Portfolio retention period:	1 day

	Maximum calculated loss with 99% certainty in million HUF	
	2019	**2018**
Average daily value	1.04	1.01
Lowest value	0.20	0.48
Highest value	2.96	2.05
At the end of the year	1.07	0.49

SVaR calculation (introduced on 28.03.2019)

	2019
Average daily value	3.74
Lowest value	0.60
Highest value	9.56
At the end of the year	4.66

In addition, the Bank operates its own VaR model using a dedicated system (Varitron), whose results are used alongside the analytical targets for limit monitoring purposes regarding foreign exchange risks, using parametric VaR calculation results at a confidence level of 99% with a 10-day retention period.

Organisational structure

The Bank's market risk management area is located within Market and Operational Risk Management, which reports to the Risk Management Methodology Directorate under the CRO. This department is responsible for all market risk analysis tasks, individual analyses and regular monitoring, also including the monitoring of market risk limits (daily, weekly, monthly, etc.). This department also conducts the rating of partners and the maintenance of related regulations. The activity is supervised by the Asset-Liability Committee, through which, and through regular monthly monitoring and limit approvals, the management is also involved in the processes.

37.10. Liquidity risk

The operative management of liquidity risks is the responsibility of the Treasury Directorate, while regulatory and monitoring tasks are carried out jointly with Market and Operational Risk Management.

In compliance with the regulations pertaining to prudent operation, the Bank is required to manage its own resources and the resources entrusted to it by other parties in a way that ensures the maintenance of both its prompt liquidity and long-term solvency. The Bank's liquidity management procedure applies to and is based on "normal" market conditions. Separate instructions regulate the requirements to be met in the case of a liquidity emergency. In addition, the procedure is based on and is in compliance with the current monetary policy and legislation; any changes affecting liquidity must immediately be discussed and the appropriate changes, if necessary, must be approved by the Asset-Liability Committee or, where appropriate, the Board of Directors.

The Bank manages its liquidity risks primarily through the establishment of appropriate processes and control mechanisms and the creation of an adequate level of liquidity reserves.

Principles to be applied in the liquidity management process:

- The Bank draws up a liquidity plan for assets, liabilities and relevant off-balance-sheet items. Continuous monitoring and updating of this plan is an essential part of the Bank's liquidity management and the management of assets and liabilities. Liquidity planning is supervised by the Asset-Liability Committee.
- A short-term (30-day, with particular attention to the first two weeks) cash flow plan is made
- concerning the Bank, broken down by day and currency at least for the first week.
- A rolling type financing plan is made concerning the Bank, broken down by month, for the next three-month period. The plan must be prepared for one expected situation and, depending on the uncertainty of the estimate, for one or more stress scenarios, in line with the MNB's recommendation on the measurement, management and control of liquidity risks.
- The liquidity forecast – in its normal and stressed versions – is prepared by the Treasury's Liquidity Management area and is submitted for approval to the Bank's Asset-Liability Committee.
- In order to monitor maturity compliance, long-term maturity coverage calculations are also required.
- Regarding customer deposits, the Bank regularly monitors and analyses the composition and maturity structure of deposits and the development of the key deposits. During the analysis, particular attention must be paid to the development of deposit concentrations

Maturity transformation is a major source of income for the Bank, however, only risks of an acceptable degree must be assumed for the sake of profitability. A strategic question is the degree of liquidity risk (maturity transformation) tolerated by the Bank's management. With regard to the maturity structure of liabilities and assets, to be established by the Bank, the Bank must strive to extend the maturity structure of the funds to be raised and to determine the maturity of loans on the basis of the structure of available/attainable funds.

Liquidity table of financial assets and liabilities –- 31.12.2019 (outstanding, non-discounted capital and interest cash flows)

Data in HUF millions

Financial assets	**Remaining maturity**						
	0-7 days	**8-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**over 365 days**	**Total**
Liquid assets	311	0	0	0	0	0	**311**
Securities	38,827	0	46,177	2	0	104	**85,110**
Loans and advances to customers	3,715	1,589	5,773	16,906	28,038	126,378	**182,399**
Receivables from the MNB and other credit institutions	139,605	0	0	0	0	0	**139,605**
Other assets	-4	0	0	0	0	270	**266**
Derivative financial assets	2,213	115	599	8,855	7,162	73,794	**92,738**
Contingent claims	6,203	0	0	0	0	0	**6,203**
of this: Guarantees, letters of credit received	1,017	0	0	0	0	0	**1,017**
Received credit lines	5,186	0	0	0	0	0	**5,186**
Total	**190,870**	**1,704**	**52,549**	**25,763**	**35,200**	**200,546**	**506,632**

Financial liabilities	**Remaining maturity**						
	0-7 days	**8-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**over 365 days**	**Total**
Liabilities to customers	183,902	15,596	38,909	7,883	6,814	22,704	**275,808**
Liabilities to the MNB and other credit institutions	53,783	6,123	5,209	2,744	3,785	31,951	**103,595**
Issued securities	0	0	0	0	0	7,195	**7,195**
Derivative financial instruments	2,211	133	552	9,058	7,719	75,931	**95,604**
Contingent liabilities	31,935	0	0	0	0	0	**31,935**
of this: Guarantees, letters of credit granted	2,816	0	0	0	0	0	**2,816**
Granted credit lines	29,118	0	0	0	0	0	**29,118**
Total	**271,831**	**21,852**	**44,670**	**19,685**	**18,318**	**137,781**	**514,137**

Liquidity table of financial assets and liabilities –- **31.12.2018** (outstanding, non-discounted capital and interest cash flows)

Data in HUF millions

Financial assets	**Remaining maturity**						
	0-7 days	**8-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**over 365 days**	**Total**
Liquid assets	346	0	0	0	0	0	**346**
Securities	58,165	0	15,309	0	69	62	**73,604**
Loans and advances to customers	592	1,767	6,359	11,643	26,486	97,372	**144,465**
Receivables from the MNB and other credit institutions	130,579	0	0	0	0	0	**130,579**
Derivative financial assets	164,636	126	0	0	0	0	**164,762**
Contingent claims	4,501	0	0	0	0	0	**4,501**
of this: Guarantees, letters of credit received	773	0	0	0	0	0	**773**
Received credit lines	3,728	0	0	0	0	0	**3,728**
Total	**358,819**	**1,893**	**21,668**	**11,643**	**26,555**	**97,434**	**518,257**

Financial liabilities	**Remaining maturity**						
	0-7 days	**8-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**over 365 days**	**Total**
Liabilities to customers	163,485	34,006	41,897	14,373	6,915	32,620	**293,297**
Liabilities to the MNB and other credit institutions	7,767	704	2,110	462	3,253	26,330	**40,626**
Derivative financial instruments	164,722	126	0	0	0	0	**164,848**
Contingent liabilities	24,771	0	0	0	0	0	**24,771**
of this: Guarantees, letters of credit granted	2,136	0	0	0	0	0	**2,136**
Granted credit lines	22,635	0	0	0	0	0	**22,635**
Total	**360,745**	**34,836**	**44,007**	**14,836**	**10,167**	**58,950**	**523,542**

37.11. Management of partner risk

During the management of partner risk, credit and trading limits are adapted to the partner risk management system as follows:
In terms of market risks, the rules for establishing partner limits and the limit management method have been approved by the Bank's Board of Directors, and continuous monitoring is performed in the Treasury's front office system (Inforex). Market risk management monitors compliance with the limits based on information from the system.
It is a general rule that the Bank only assumes any obligation that entails risk-taking if an approved limit exists. For any bank/partner and customer with whom the Treasury wishes to conclude a business transaction that entails risk-taking, a limit approved by a body with the appropriate decision-making powers must first be set, or the credit risk must be excluded.
Derivative transactions are typically concluded with partners in the framework of ISDA, CSA, and GMRA agreements.
In the process of setting limits and analysing and monitoring partners, the following factors must be taken into account, also meeting the relevant stipulations of the Partner risk assessment policy, the Customer and partner rating policy and the Partner limit management policy:

- Collateral that can be recognised in terms of capital reduction, such as government/surety guarantees, financial collateral, property collateral. The degree of coverage required for the partners depends on the partner rating and the magnitude of the partner as detailed in the Collateral measurement policy.

In the case of an institutional partner, the Bank typically does not open a partner limit based on collateral different from financial or other guarantees.

- In order to manage wrong-way risk exposures, partner groups and group limits are set up for partners between whom a credit risk dependency exists.

For each Treasury transaction (pre-settlement, loan settlement, issuer, etc.), the Bank determines the risk weight and percentage charge for the given transaction in the manner and to the extent specified in the Partner limit management policy, charging them to the limits set for the partner institution.
In order to identify and manage risks, partner rating as a function involves, on the one hand, an examination that is performed before the assumption of the exposure, as well as continuous risk monitoring.
Limit monitoring and customer risk measurement as a minimum requirement for monitoring is complemented by close cooperation with the required quarterly receivables rating and responsibilities related to collateral in accordance with the Transaction rating and coverage measurement policies.
Partner ratings must be reviewed at least once a year, or whenever an event arises that requires a review of the rating. The measurement of partner risk must take into account related market, liquidity, legal and operational risks. During the monitoring process, the Bank also monitors the transparency of the partner/group.
If any of the analysts or managers of the Bank becomes aware of significant warning signs (e.g.: the Partner's external rating deteriorates, its economic situation worsens significantly, the launch of bankruptcy or winding-up proceedings is published, there are long-term payment delays, etc.), the rating must be updated immediately after the information has become known. In justified cases, an extraordinary rating may serve as a basis for measures to promote the Bank's security.
In the case of negative news from the market, the manager of Treasury or the Risk Management may temporarily suspend the partner limit applicable to the Bank's given partner.
The Asset-Liability Committee has the decision-making power to close a partner limit or to terminate the existing transactions.
The Bank basically limits the risk of a deposit placement arising under ISDA agreements unexpectedly, maybe as a result of the Bank's downgrading, by minimising its trading activity in the area and typically only taking hedging positions, i.e. overall holding moderate net derivative positions. In addition, when regulating the minimum level of liquidity reserves, the Bank takes into account the preparation for stress situations and the results of stress tests that are run regularly.
When concluding ISDA agreements, the Bank can properly enforce the principle of symmetric obligations between the parties and the observance of market standards.

With regard to partner risk, for the transactions listed in Annex II to Regulation (EU) No 575/2013, the Bank determines the exposure value on the basis of the market pricing method.

37.12. Operational risk

The objective of operational risk management is to support efforts to keep operating costs low, and to promote efficient organisational operation.
The Bank primarily manages operational risks by focusing on prevention and with the continuous monitoring and appropriate elaboration of internal regulations and procedures, the collection of events, self-assessment, the appropriate training of employees participating in the work processes, and the ongoing development and implementation of built-in control mechanisms.
Measurement of risk levels is effected through the continuous gathering of data on events that occur, and regular self-assessments based on forward-looking department-level estimates. These surveys outline the patterns in the distribution of the events, thereby helping to identify the areas for any necessary intervention. The process is supported by the network of operational risk officers designated in every department of the organisation.

All operational risks are to be reported to the operational risk manager, and a relevant report must be submitted to the Asset-Liability Committee on a quarterly basis and at least annually to the Board of Directors. The Bank prepares an annual self-assessment concerning its operational risks, which is also reported to the ALC and the BD.

Based on the collection of loss events, it can be stated that the conservative capital requirement rate created using the robust basic indicator approach under Pillar I (HUF 761 million) was sufficient to cover operational risks in 2019. By 2019, the Bank completed its self-assessment of operational risks and, according to the results of the audit, no further capital formation is required.

37.13. Risk of excessive leverage

The Bank monitors the risks resulting from excessive leverage through monthly monitoring. The Bank calculates leverage on the basis of the relevant Regulation (EU) 575/2013 and reports it to the Asset-Liability Committee.
The Asset-Liability Committee is entitled to order specific measures in case the value of the indicator falls below the alert level or below the limit value.

37.14. High-risk portfolios

The Bank sets limits for "High-risk portfolios" (balloon, bullet, portfolios built with the cooperation of an independent intermediary, etc.) as defined by the MNB, and accordingly the Bank develops a diversified portfolio paying special attention to risk assessment prior to credit decisions and follow-up management of loans. The Asset-Liability Committee receives monthly information on portfolio developments and limit utilisation.

37.15. Risks considered as not relevant and their justification

Risk of securitisation:

The Bank does not plan to act as a risk transferor, risk taker or sponsor concerning securitisation transactions.
Modelling risk:

The Bank uses control processes to handle modelling risks, which include regular validation and measurement and repeated measurement, where applicable. Modelling risk arises primarily from VaR models related to impairment and provisioning, and market risk.

38. CAPITAL AND CAPITAL ADEQUACY

The following tables show equity in two structures, as required by Section 114/B of Act C of 2000 in order to facilitate the comparability of equity components presented in these IFRS statements with those presented in previous years' HAS statements.

Data in HUF millions

Based on IFRS financial statements

	31.12.2019	31.12.2018
Subscribed capital	8,494	8,494
Capital reserve	4,477	4,477
Profit reserve	1,065	51
Reserve for share-based payment transactions settled in equity instruments	139	92
Other reserves	397	280
Cumulative other comprehensive income (OCI)	-33	-101
Total equity	**14,539**	**13,293**

Based on the Hungarian Accounting Act (Act C of 2000, Section 114/B)

	31.12.2019	31.12.2018
Share capital under IFRS	8,494	8,494
Capital reserve	4,616	4,569
General reserve	397	280
Valuation reserve	-33	-101
Profit reserve	-46	-989
Profit after tax	1,111	1,040
Total equity	**14,539**	**13,293**

Information about regulatory capital

Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises and Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (CRR) require that the Bank have a certain level of regulatory capital. The Bank reports its capital adequacy position to the National Bank of Hungary (MNB) on a quarterly basis, and forecasts are regularly made regarding the expected capital adequacy developments.

Data in HUF millions

	31.12.2019	**31.12.2018**
Common equity Tier 1 capital (CET1)	12,176	11,291
Additional Tier 1 capital (CET1)	5,150	0
Total Tier 1 capital	**17,326**	**11,291**
Subordinated loan capital	100	5,250
Total Tier 2 capital	**100**	**5,250**
REGULATORY CAPITAL	**17,426**	**16,541**

During the years 2019 and 2018, as well as on 31.12.2019 and 31.12.2018, the Bank met the capital adequacy requirements of the MNB. The Bank pays no dividends from this year's profit.

On 22.04.2020 the Board of Directors approved the financial statements.

Éva Hegedűs — Chairman & CEO

Jenő Siklós — Deputy CEO

GRÁNIT BANK
PRIVATE LIMITED COMPANY

CONSOLIDATED BUSINESS REPORT

31 DECEMBER 2019

BUDAPEST, 22 April 2020

CONSOLIDATED REPORT OF THE BOARD OF DIRECTORS

ON BUSINESS OPERATIONS IN 2019

1. Introduction to the GRÁNIT Bank Group

1.1. A brief history

In the last nine business years the Bank Group has consistently achieved dynamic growth, and in doing so it has proved that an innovative business model that focuses on digital solutions can be as successful in Hungary as elsewhere.

The GRÁNIT Banking Group closed its most successful business year to date in 2019

The Bank started trading under the name GRÁNIT Bank in May 2010, when it was still effectively an empty, "greenfield" bank operating with total assets of barely over HUF 7 billion. After nine and a half years of operation, as at the end of December 2019, GRÁNIT Bank had achieved a balance sheet total of nearly HUF 400 billion and a pre-tax profit of HUF 1,376 million, increasing business activity almost fifty-fold and continuously growing the number of its retail and corporate customers, and the volume of deposits and loans.
As a result of this dynamic growth, GRÁNIT Bank has now become a mid-sized bank, and the business model it has implemented has brought it widespread professional recognition. The Bank participates in a wide range of economic development and retail programmes (MNB NHP, NKP bond programme, MFB Points, Eximbank refinancing schemes, CSOK, etc.), has been a BUBOR market maker since 2018, actively participates in programmes for developing financial literacy, is a committed promoter of environmentally conscious banking, and in addition, supports the development of local culture and sports.
GRÁNIT Bank established GB Solutions Zrt. (GBS) at the end of 2018, which is a wholly owned fintech company of the Bank. The task of GBS is to elaborate and implement IT developments and innovative business solutions in co-operation with the Bank, as well as for third-party customers.

The Bank is an attractive investment opportunity for investors, as is reflected by the fact that its circle of owners is constantly expanding. The Bank is entirely owned by domestic private and institutional investors.

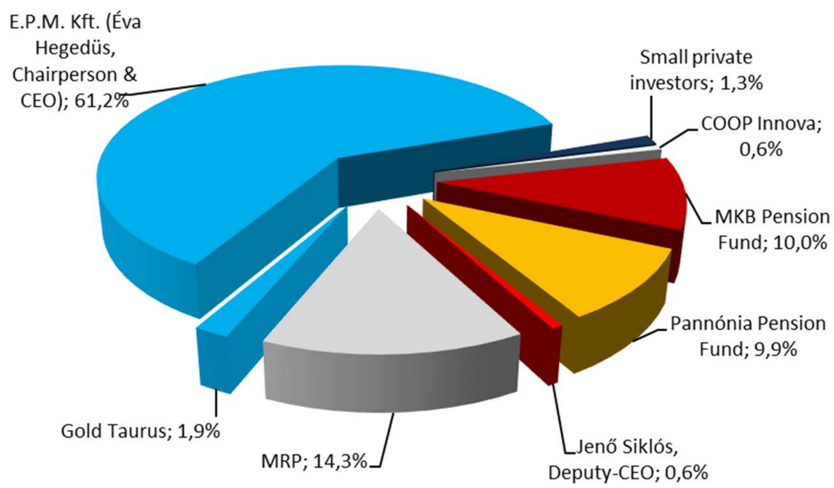
1.2. The Bank's ownership structure

Since 2010, GRÁNIT Bank's circle of owners has steadily grown to include bankers, business people and a retail chain. In 2013, the Hungarian State became a minority owner. The state acquired its stake in the Bank in accordance with the market investor principle, and the majority ownership of the Bank remained with the private investors throughout.
On 20 July 2017, the Hungarian State issued a two-round open tender for the sale of its stake in the Bank. The winning bidder in the tender was the E.P.M. Kft., and this was officially announced on 22 December 2017. The transaction was completed in the first half of 2018.

During 2017, GRÁNIT Bank launched a three-year employee stock ownership plan (ESOP), the main goal of which was to further motivate employees to increase shareholder value in the long term. By subscribing new shares, the ESOP entity has become a nearly 15% owner in the Bank.

The current ownership structure of the Bank as at 31 December 2019 is shown in the figure below.

Ownership structure of GRÁNIT Bank



1.3. Management of GRÁNIT Bank

The Bank's management has remained unchanged since the beginning

The management team tasked with the Bank's day-to-day management and operation has remained unchanged since the Bank's inception. The table below shows the composition of the Board of Directors and the Supervisory Board as at the end of December 2019.

Board of Directors	Supervisory Board
Éva Hegedüs (Chairwoman & CEO) Jenő Siklós (Deputy CEO) Zoltán Nagy (Deputy CEO) László Hankiss (Deputy CEO) Gergely Domonkos Horváth	Sándor Nyúl (Chairman) János Vokony Gyuláné Lajtos

2. Macroeconomy

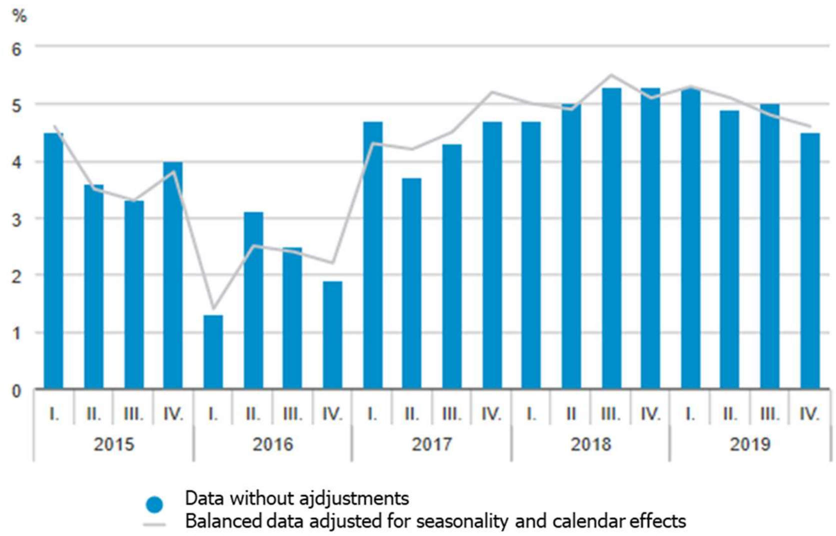
Hungary's economy achieved outstanding growth in 2019

According to KSH data, the Hungarian economy grew by 4.9% in 2019 year on year, similarly to 2018. In 2019, the Hungarian economy expanded at the second fastest pace in the EU after Malta, and by almost 3.5 percentage points faster than the EU average of 1.5%. The growth was broad-based, with almost all sectors of the economy growing. The growth was mainly driven by market-based services (e.g. trade, tourism), and to a lesser extent by industry and construction, with the expansion supported by rising consumption and investment activity. Household consumption is contributing increasingly to economic growth as a result of rising wages and a low-inflation environment, given that, despite rising price levels, real wages have increased steadily for the seventh year in a row. Services contributed the most to growth on the production side, and capital investment contributed the most on the demand side. The pace of construction and industry output also quickened significantly, thanks to government measures to support housing construction, the use of

EU funds, capacity expansions and an upturn in the external economy, as well as to the dynamic expansion of capital investments in the national economy. The performance of the services sector strengthened further in 2019 after strong expansion in 2018, the primary driver of which was the 11.4% year-on-year increase in real wages, supported by strengthening labour-market demand, a rise in the minimum wage, as well as the stimulus generated by the six-year wage and tax agreement framework. The external vulnerability of the economy continued to decline in 2019. Hungary's equilibrium indicators are favourable; Hungary's current credit ratings by the main rating agencies are as follows: Moody's: Baa3 (outlook: stable), S&P: BBB (positive), Fitch: BBB (stable). In the third quarter of 2019, Hungary's four-quarter external financing capacity according to the real economy approach increased to 1.1% of GDP, while the current account deficit fell to 0.8% of GDP. The external financing capacity of the Hungarian economy remains high compared to the rest of the region, and the current account balance is in line with the trends seen in the other countries of the region. Consistently with the external financing capacity, Hungary's external debt ratios continued to decline, general government net external debt decreased, and the value of Hungary's foreign exchange reserves increased, with this figure still significantly exceeding the level expected by investors as regarded as safe.

2.1. Gross domestic product (GDP)

The volume of gross domestic product of the Hungarian economy in the fourth quarter of 2019, according to the KSH's second estimate, was 4.5% higher than in the same period of the previous year. The growth was driven mainly by market-based services and to a lesser extent by industry and construction. According to seasonally and calendar-adjusted and balanced data, the performance of the economy increased by 4.6% year-on-year and by 1.0% quarter-on-quarter. In 2019 overall, the performance of the economy increased by 4.9% compared to the previous year.



Source: KSH

On the production side, the value added of construction increased by 21%, that of industry by 5.0%, and that of services by 4.2%. In December 2019, the volume of exports decreased by 0.5%, while the volume of imports increased by 4.3% compared to the same period of the previous year. In the full year of 2019, compared to the figure a year earlier, the value of exports decreased by 1.3% in euro terms, while that of imports increased by 2.3%. The volume of exports to Member States of the European Union decreased by 3.4%, and the volume of imports from them increased by 2.3%, with these countries accounting for 77% of all Hungary's exports and 73% of all its imports.

The development in the trends in foreign trade was also influenced by the change in the forint exchange rate. The forint depreciated by 2.4% against the euro and by 4.9% against the dollar compared to a year earlier. The devaluation has also had an impact on producer and consumer prices through the consumption of imports, with consumer prices increasing by 3.4% on average in 2019.
In the period October-December 2019, the average number of employed persons was 4,520,000, or 38,000 more than a year earlier. Looking at 2019 as a whole, the employment rate among 15-64 year olds was 70.1%, 0.9 percentage points higher than in the previous year.

2.2. Changes in the interest environment

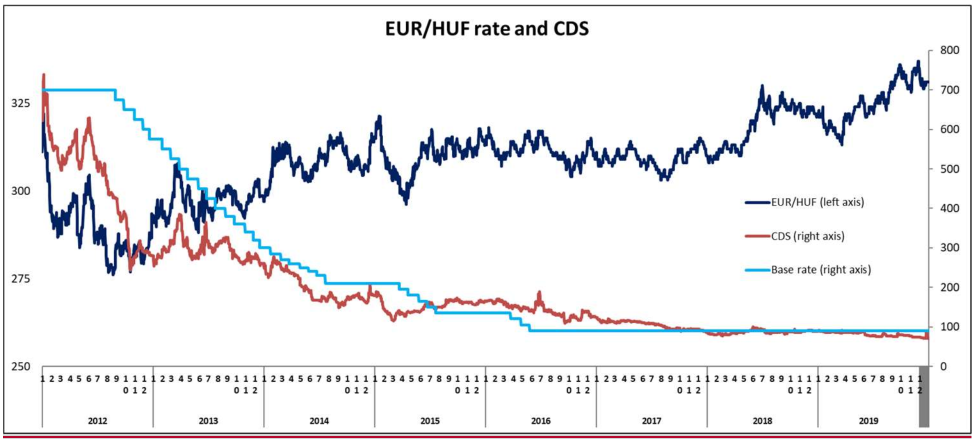
In 2019, the National Bank of Hungary (MNB) kept the base rate unchanged at 0.9%.
The MNB's monetary policy toolbox was altered several times in 2019 as well. In 2019, the IRS transactions maturing under the HIRS programme (the MNB's lending-related interest rate swaps scheme) were derecognised, thus transforming the Preferential Deposit system. Banks can use this latter facility up to the amount loaned under the NHP (Funding for Growth) "Fix" programme announced at the end of 2018, and also up to a specified rate of participation in the Growth Bond Programme launched in the second half of the year. Through this, the MNB sterilises the surplus quantities of money generated by the various growth-stimulating programmes. The MNB continues to actively use the EUR/HUF FX Swap tender, which provides 1, 3, 6 and 12 months of forint liquidity. With this, it effectively regulates the amount of liquidity in the banking system.
Meanwhile, the level of BUBOR interest rates, which underlies the pricing of retail and corporate loans, rose from a historic low in 2018 (0.02%) to 0.27% in July 2019, closing at 0.16% at the end of December. The Fed cut the key interest rate band three times in 2019, and it is currently moving in the 1.50-1.75% range.

In order to offset the economic impact of the coronavirus, central banks moved towards monetary easing in early 2020, thus reversing the trend of rising interest rates in developed countries, and more economic stimulus measures are expected in 2020. The Federal Reserve (Fed) again reduced its key rate to close to 0% in two extraordinary meetings, and also took significant liquidity-providing measures and relaunched its asset purchase (quantitative easing) programme. The European Central Bank (ECB) left its key rates unchanged, while also announcing significant easing and liquidity-providing measures.
In Hungary, the MNB announced a broad range of instruments in March-April 2020 in order to offset the negative economic impact of the coronavirus. In this context, it provides significant additional resources for businesses to deal with the situation on a temporary basis and for medium-term developments. The announced measures

will create conditions for the banking system that will stimulate lending on the one hand while stabilising the economy on the other. At the same time, the measures help to achieve and maintain price stability, as well as to move the yield curve downwards and reduce exchange rate volatility. The announced measures seek to address the situation in a complex, multi-faceted way, hopefully giving sufficient impetus to economic operators to recover quickly. In relation to this, further monetary and fiscal measures designed to stimulate economic growth are also conceivable. Interbank interest rates may, however, be higher than in 2019 due to the appreciation of liquidity.

At the start of 2019, Hungary's debt rating was also upgraded by two credit rating agencies (S&P and Fitch). Hungary is in the investment category with all three major international credit rating agencies. These ratings confirm the assessment of the country by investors.

The EUR/HUF exchange rate moved in the 312-336 range in 2019, ending the year at 331 forints to the euro. Based on market forecasts, it is expected to move in a wider range in 2020, between 330 and 360. The bankruptcy risk indicator was characterised by a moderate fall in 2019, hovering at around the 81 mark on average, and reaching 71 at the end of December 2019.



2.3. Credit institutions sector

According to Q1-Q4 2019 data, the Hungarian credit institutions sector posted total profit before tax of HUF 550 billion, which was HUF 30 billion or 5.3% lower than in the same period of the previous year, though before impairment and risk provisions, there was a 5.3% increase.
The balance sheet total of the credit institutions was 10.2% higher at the end of 2019 than one year before. The loan portfolio of credit institutions grew by 15.2%, with corporate loans growing by 12.2% and household loans by 18.1%. Based on the consolidated data of the credit institutions, the share of non-performing loans decreased from 5.4% in 2018 to 4.0%. The ratio of loans overdue for more than 90 days in the household sector decreased from 7.4% in the previous year to 5.2%, and in the case of non-financial companies, it decreased from 2.8% to 2.0% by the end of 2019 compared to the same period of the previous year.

To stimulate lending to small and medium-sized enterprises and to promote economic growth, on 1 June 2013 the MNB launched the Funding for Growth Scheme (FGS in English, or NHP in Hungarian), which, with its two phases combined, led to a resurgence in growth in SME lending volumes. The FGS had a beneficial effect on investment activity, employment and economic growth overall. At the start of 2016, the third phase of the FGS was launched as part of a growth support programme to help banks switch to market lending, At the end of 2018, the MNB announced a new FGS programme, under the name "NHP Fix" (FGS Fix in English). The growth rate of lending to the SME sector is being sustained by the FGS Fix product, and the expansion of corporate lending is being facilitated by the Growth Bond Programme announced by the MNB in 2019.

In terms of the growth in household loan volumes, an important contributing factor was the borrowing linked to the "babaváró" support scheme for expectant mothers launched in July 2019, a product that is likely to serve as a catalyst for growth in retail lending in general in 2020, while the measures launched under the Family Protection Action Plan will also provide support for an upswing in demand for loans.

2.4. Outlook

Gross domestic product of the Hungarian economy grew by 4.5% in the fourth quarter of 2019 compared to the same period of the previous year, whereas the volume for the year as a whole, according KSH data, increased by 4.9%. According to forecasts, the dynamic growth of the domestic economy could continue into 2020, though growth is likely to be slower than before, depending on how long it takes for the coronavirus epidemic to play itself out. According to the MNB's baseline forecast, growth may be 2-3% in 2020, but the uncertainty of the forecast is significantly higher than usual given the current circumstances. Any prolongation of the epidemic globally or in Hungary could even push GDP growth into negative territory. Looking ahead, growth in Hungary will continue to be supported by expanding domestic demand, with the expansion in consumption being driven by dynamic real-wage growth, high net financial wealth accumulation, and a pick-up in retail and corporate lending, though our country will not be able to insulate itself from external economic forces.

Corporate loan volumes increased by 14% in 2019, and within this, lending to the SME sector also increased 14%, while lending to the household sector grew by 17% in 2019. In terms of the latter, an important contributing factor was the borrowing linked to the "babaváró" support scheme for expectant mothers launched in July, a product that is likely to serve as a catalyst for growth in retail lending in general in 2020, while the measures launched under the Family Protection Action Plan will also provide support for an upswing in demand for loans. The growth rate of lending to the corporate SME sector is being sustained by the FGS Fix product, and the expansion of corporate lending is also being facilitated by the Growth Bond Programme announced by the MNB in 2020.

In its forecast for global economic growth for 2020, the IMF forecast 3.3% and the OECD forecast 2.9%; however, due to the outbreak of the coronavirus, economic forecasts are constantly being revised downwards and the probability of a global economic downturn is increasing. Global economic developments continue to be affected by the UK's exit from the European Union, foreign trade tensions between the US and China, and the possibility of escalating geopolitical conflicts in ever more places around the world, which could negatively impact production and investor sentiment. Due to ongoing climate change and the extent of environmental pollution, the current rate of consumption is not sustainable in the long run, and so the use of new technologies and the transformation of consumer habits is required in order to maintain and improve living conditions. If conflicts of interest between the major powers and competition between them for the top positions intensify further (e.g. a trade war between the United States and China), this could be a significant impediment to growth. Each country needs to engage in a more intensive multilateral dialogue to mitigate risks and co-ordinate their economic and financial measures to improve economic prospects.

Although the world's major central banks (the Fed, the ECB and the Bank of Japan) are providing satisfactory monetary conditions for global growth, supportive monetary policy instruments have reached their limits in the developed countries and long-term yields can be expected to rise. At the same time, in order to mitigate the economic impact of the coronavirus, monetary stimulus can be expected to return to the fore in 2020. As a result, there may be a reshuffling in terms of relative interest rates among the larger economic blocks, and this could have a significant impact on the money and capital markets.

3. GRÁNIT Bank Group's business strategy

The Bank's digital strategy is unchanged: delivering quality financial services to corporate and retail customers through innovative electronic channels

GRÁNIT Bank, a domestically owned bank that is committed to improving the competitiveness of the Hungarian economy, aims to serve household customers and small and medium-sized enterprises as a strategic partner, and to provide innovative and integrated financial services, as a result of which finances can be managed simply, conveniently and quickly, as well as flexibly in terms of time and space.

A key element of GRÁNIT Bank's strategy is to provide corporate and retail customers with clearly understandable, yet high-quality and value-added financial services through customised solutions in the context of a cost-effective operating model. GRÁNIT Bank wishes to leverage all the technological advances of the modern age to provide a fast and convenient customer service, while at the same time considering the environmental ramifications of its business, and for this reason it ascribes a key role to the provision of services through electronic channels.

GRÁNIT Bank is a partner in the pre-financing and co-financing of state and EU subsidies, and has an interest in the long-term operation of the projects thus implemented. In this regard the Bank relies, in strategic terms too, on relationships with large corporations that, with the Bank's active involvement, can help stimulate the small and medium-sized enterprise sector.

Other key areas of the Bank's strategy include the provision of retail payment services, the sale of diversified account packages based on varied customer habits, the provision of investment services, and the sale of housing loans and overdraft facilities to its customers. The Bank also builds on the owners and employees of its corporate clients using financial services, who can conduct their personal banking at GRÁNIT Bank on favourable terms.

The basis of the Bank's strategy is to develop its services for retail and corporate customers in line with the latest developments in electronic banking, and at the same time to optimise its internal processes for this purpose. The changes in the available means of using banking services, in parallel with the spread of the internet and mobile devices (laptops, smart phones, tablets), has generally resulted in the vast majority of transactions already being conducted electronically, while a considerable proportion of sales are no longer generated by the traditional branch networks, and sales of financial services – including the opening of first accounts – over the internet are also growing.

GRÁNIT Bank's business model assures lower costs than the average for the banking sector (in terms of operating costs/total assets, GRÁNIT Bank's 0.9% figure is already significantly better than the 2.3% average for the banking sector), and this allows the Bank to provide customers with sustainably competitive terms while still achieving a high rate of return and profitability. This strategy is in line with the changes in customer habits, as numerous international and domestic research studies show that the proportion of people who bank online, and more specifically, on their mobile phones, is growing.

The Bank achieved profitable operation significantly sooner than the international benchmark, in its fourth full business year, and has consistently posted a profit ever since. 2019 was its sixth profitable year.

The Bank has achieved an average growth of 52% over the past nine and a half years, proving that customers satisfied by high-quality, innovative financial services offered at favourable terms can be acquired even in a highly competitive environment.

4. The Bank Group applies a sustainable business model and conducts an increasingly wide range of CSR activities

The Bank Group's digital business model uses resources efficiently and at the same time promotes the development of sustainable economic structures

The GRÁNIT Bank Group makes sustainable, cost-effective banking available to a wide range of consumers through new, high-tech digital solutions that are free for customers. The VideóBank, NetBank and eBank applications come as free basic functions with the account package, and the chat function that is available in VideóBank helps people with disabilities to manage their finances. 100% digital, paperless bank-account and securities-account opening enables a significant reduction in environmental impact.

In 2019, for the 4th year, the Bank supported IT training in Hungary through a high-value-prize ideas contest for university students, which in 2019 produced 25 high-quality projects.

Every year, the managers of the Bank Group participate as volunteers in its "Pénz7" (MoneyWeek) programmes for school financial education, as well as in university lectures to introduce young people to the latest banking technologies.

The Bank has been a major supporter of kayaking and canoeing for many years, including in both the competitive and recreational sports arena. The Chairman & CEO of the Bank, as the social chairman of the Hungarian Water Polo Association, helps ensure the success of the sport.

The digital business model protects the environment and contributes to healthier living conditions

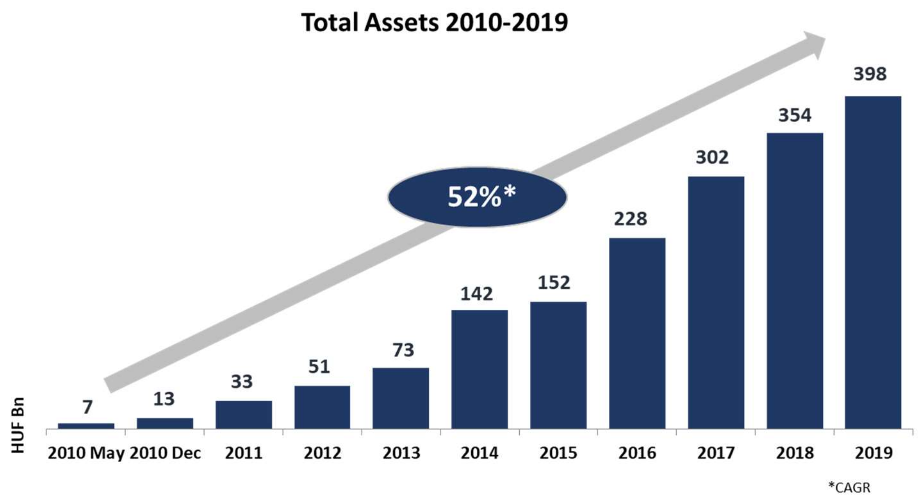
GRÁNIT Bank is participating in the MNB's Green Finance Programme, and in March 2019 it won the Green Finance Innovator Award. By opening a VideóBank account, its customers have helped cut more than 30 tons of carbon dioxide emissions from July 2017 to March 2019. By shifting to a 100% paperless operation, the Bank has saved nearly 4,000 trees during its existence, and has a wide range of products that are regarded as "green" in international practice. Based on the number of its customers, with a traditional banking operation GRÁNIT Bank would need eight branches instead of the current one, i.e. it provides high-quality services with just one-eighth of the usual branch complement, which makes it Hungary's financial institution with the smallest ecological footprint. To support sustainability, the VideóBank and the eBank mobile applications are also set as free basic functions for retail account packages. The Bank is providing more than HUF 10 billion in financing for various projects related to green-energy production that will help combat climate change.

5. Report on business operations in 2019

The Gránit Bank Group closed its ninth full business year with outstanding results

In 2019, the Bank continued the bank-building process in accordance with the long-term strategy adopted by the Board of Directors, and as a result of the increase in business activity, the Bank's balance sheet total approached HUF 400 billion by the end of 2019, a 13% increase compared to the previous year and a more than fiftyfold expansion since the Bank's launch in May 2010.

GRÁNIT Bank broke into profit in 2014, its fourth full business year, as a result of the capital investments it had made until then and the building of an excellent portfolio. In 2019, the Bank Group achieved a pre-tax profit of HUF 1,376 million, which was 12% higher than the previous year's profit.



Total deposits at the Bank Group increased by 1.5% compared to the previous year, exceeding HUF 307 billion. The retail government securities launched in

2019 offered significantly higher yields than before, and thus had a major diversionary effect on deposits. Customer savings held at the Bank (deposits and government securities) exceeded HUF 350 billion, which was 5.6% higher than at the end of the previous year.

The Bank Group's total exposure (loans, bonds and guarantees combined) exceeded HUF 197 billion, 22% higher than at the end of the previous year. Within the corporate loan portfolio, the share of loans of the SME sector was 56% as at the end of 2019. The quality of the portfolio remains excellent: the ratio of performing loans is 99.96%, principally as a result of the Bank's conservative lending policy.

70% of retail customers initiated the opening of their account online

The number of the Bank's customers grew dynamically last year, due in no small part to the high level of customer satisfaction it enjoys and to people's growing awareness of the Bank. The digital strategy is also an integral part of the Bank's marketing: our surveys have shown that almost 70% of retail customers come across the Bank online and then become customers, while a third become customers on the recommendation of an existing GRÁNIT Bank customer. More than 70% of customers opened their account with GRÁNIT Bank in 2019 in a completely digital way.

Innovative digital solutions for customers to manage their finances

The Bank regards the continuous expansion of its range of convenience services provided to customers as a basic business objective. It had already been possible to open an account online simply and quickly using the account-opening interface developed by the Bank, but on 20 July 2017, after fulfilling the required legal conditions, GRÁNIT Bank became the first bank in the country to launch an online account-opening function linked to video-based authentication, with its state-of-the-art GRÁNIT Bank VideóBank service. Thanks to this development, the Bank's prospective customers are able to open a fully usable retail bank account from anywhere in the country without having to show up in person. With this innovative service, for the first time in Hungary a bank account can be opened on a smartphone, laptop or desktop computer, without visiting a bank branch. An account can be opened in as little as 15 minutes, during which time the customer receives his or her contract and can already transfer money to the account he or she has opened. Experience shows that a full 70% of the Bank's retail customers open their account in VideóBank or via another online channel.

Customers attend to most of their day-to-day financial matters via the NetBank, using a computer or an application optimised for smartphones, and monitor their card transactions via text message. GRÁNIT Bank uses electronic signatures, so all bank certificates and documents are available to customers via the NetBank. If customers have questions, they can use the live-voice call centre or VideóBank, which provides the personal banking experience mentioned earlier. With the VideóBank service, which is unique in the Hungarian market, the customer can get into personal contact with one of the Bank's administrators, receive documents and carry out transactions without having to queue up or travel.

In 2014, the Bank introduced the innovative GRÁNIT eBank service, which has been continuously developed since then for the convenience of customers and through which it can also reduce costs for customers. The essence of the solution, refined in 2015, is that, by bypassing the telephone service providers, a direct connection is established between the Bank's account management system and the smart phone, so instead of paying SMS fees, customers receive information on their transactions in the form of an iSMS free of charge.

Launched in 2016 as the first service of its kind to be introduced in Europe, GRÁNIT Pay is a new-generation mobile banking wallet, which is able to digitise a bank card in a few seconds, after which the NFC compatible Android phone can be used to pay at touch-pay enabled POS terminals.

In the summer of 2018, for the first time in the Hungarian banking market, the GRÁNIT Bank's mobile banking application was extended to include a cost-analysing financial management function (My Finance), a function that until then had not been integrated into any mobile banking application. In the first phase, the module of the version available on iOS shows the expenditures and revenues, which are represented by the app's self-learning algorithm on charts, in a monthly breakdown, categorised by type. Customers were able to block and unlock their card through the app before, as well as to set limits on card transactions (separately for purchases via a physical POS terminal, for ATM cash withdrawals and for online purchases); what is new here is the ability to launch transfers and to open time deposits. With these services, customers can effectively hold their personal bank branch in their hands via their smartphones, reflecting the Bank's slogan "My mobile is my branch". The application can also be downloaded from the app store and from the Android marketplace. This solution is becoming more and more popular among customers, as the smartphone is effectively the new bank branch that can be accessed at the touch of a button without having to travel or queue, and through which customised solutions needed to achieve private or business goals can be found.

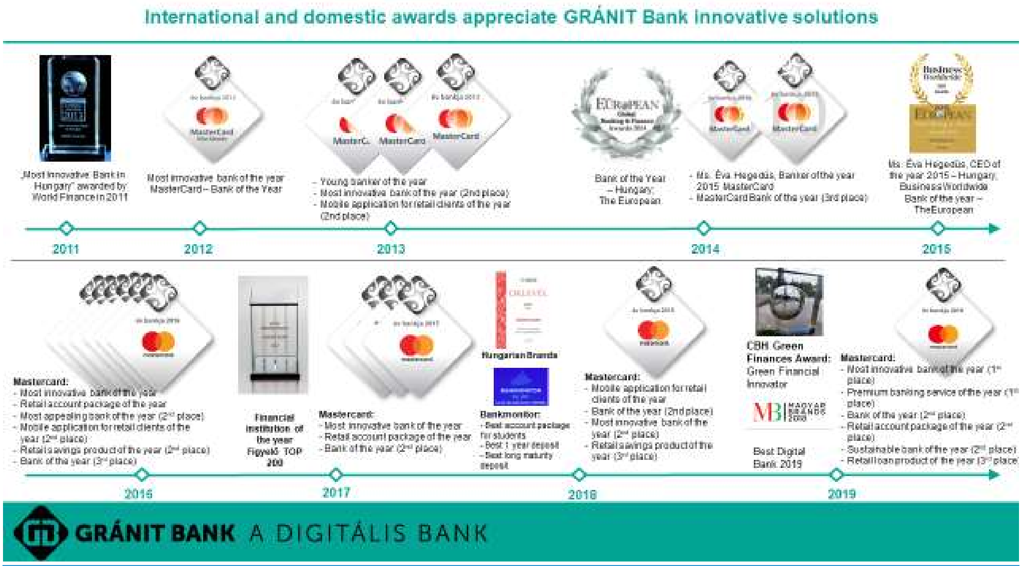
New additions in 2019 include, as part of the drive to expand digital functionality, the option of opening a securities account and purchasing government securities through VideóBank, which is also available via the internet banking system. Besides this, the Bank introduced a function enabling retail customers to apply for a "babaváró" loan online, and added ApplePay to its own GránitPay function.

All of these innovative solutions and services, tailored to suit customer needs, are a part of the "**Bank of the Future Today**" concept being implemented by GRÁNIT Bank.

In 2019, the performance of GRÁNIT Bank was acknowledged through nine awards

In 2019, GRÁNIT Bank won "podium places" in a total of six categories in the MasterCard Bank of the Year competition. The independent jury awarded the Bank the title of Most Innovative Bank of the Year, and GRÁNIT Bank was also named Premium Banking Service Provider of the Year. In justifying the awards, the jury emphasised that the Bank is committed to offering the most innovative payment solutions and value-added, digital, premium financial services to all its customers.

The Bank was awarded the title Green Financial Innovator under the Green Finance Award scheme launched by the MNB in 2019 in recognition of its achievements in the field. The Bank also won the Hungarian Brands award and the title of Best Digital Bank.



5.1. The Bank Group's key financial indicators

The balance sheet total of the Bank Group reached HUF 398 billion

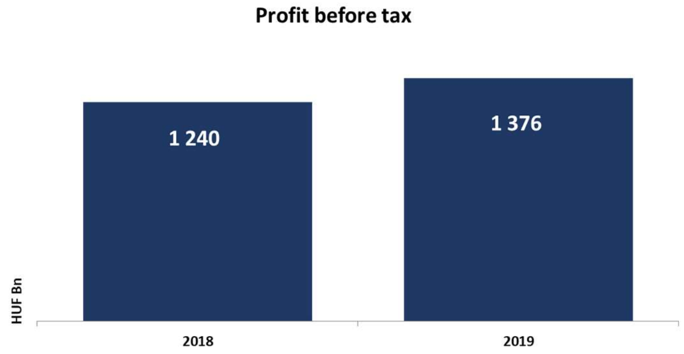
At the end of December 2019, the Bank's balance sheet total had reached HUF 398.0 billion, which is 13% higher than the balance sheet total at the end of 2018.

The Bank Group's equity as at 31 December 2019 was HUF 14.5 billion, which is 9% higher than at the end of the previous year.

Total Assets, Results (HUF Bn)	2018	2019	Change
Total Assets	353 466	398 037	113%
Loans to customers	143 814	167 048	116%
Liabilities to customers	295 134	298 813	101%
Equity	13 293	14 539	109%
Regulatory capital	16 541	17 426	105%
Profit before tax	1 240	1 376	111%
Profit after tax	1 040	1 118	108%

In its sixth profitable business year, the Bank Group achieved a pre-tax profit of HUF 1,376 million

The Bank Group achieved a pre-tax profit of HUF 1,376 million in 2019, which is 11% higher than the previous year's profit of HUF 1,240 million.



The financial indicators of the Bank Group again developed favourably in 2019

International experience shows that 6-8 years are usually required following launch to reach the profit-generating phase, and so it can be regarded as an exceptional achievement that GRÁNIT Bank was already operating profitably by its fourth full year of business. This exceptional result was due to the excellent quality of its portfolio and of its cost-effective digital business model.

Indicators		**2018**	**2019**	Change
EPS (profit after tax/number of shares)	HUF	122	132	108%
CIR (operating expenses/net business profit)	%	70,4%	73,8%	105%
ROAA (return on average assets)	%	0,3%	0,3%	97%
ROAE (return on average equity)	%	7,9%	8,1%	103%
Not performing loans ratio	%	0,0%	0,0%	0%

The Bank also ensured the fulfilment of the capital adequacy ratios specified in the legal conditions during 2019, with its Total Capital Adequacy Ratio being 12.4% as of 31 December 2019.

Capital adequacy	**2018**	**2019**
Capital adequacy ratio	14,1%	12,4%

On the value date 29 March 2019, GRÁNIT Bank issued an open-ended bond called GRÁNIT 2019/A in an amount of HUF 5,150 million (ISIN code: HU0000358866). According to the bond prospectus, the GRÁNIT 2019/A bond could also be paid for by exchanging them for the GRÁNIT 2027/A bonds issued by the Bank on 24 October 2017 (hereinafter: "T2 Bonds"). The subscribers of the 2019/A bond took this opportunity – with the exception of a HUF 100 million bondholder. The terms of the GRÁNIT 2019/A bond comply with Article 52 of the CRR and may therefore be considered as additional core capital instruments (hereinafter: "AT1 Bonds").

The sale of the 2019/A bonds and the redemption of the 2027/A bonds resulted in the Bank replacing the majority of the T2 Bonds with better quality regulatory-capital instruments (AT1 Bonds). The completed transaction thus strengthened the capital position of the Bank Group.

In 2019, in line with the significant increase in business activity – the number of customers increased by 19% – the number of employees of the Bank Group increased by 28, to 139.

Number of employees	**2018**	**2019**	Change
Number of employees	111	139	125%

5.2. Liabilities

The loan-to-deposit ratio was 50%, making GRÁNIT Bank one of the most liquid banks in Hungary

The Bank Group was able to continuously provide favourable offers to its customers even in the low interest-rate environment, and so the deposit portfolio increased by 1.5% by the end of 2019 compared to the end of 2018, thus exceeding HUF 300 billion. The average annual growth in deposits was 53% between the time of the Bank's foundation and the end of the reporting period. With regard to deposit taking, the entire banking system was affected by the investment opportunity presented by the new retail Hungarian government securities schemes available from 3 June 2019, which explains the more subdued growth rate of the deposit portfolio. Customer savings held at the Bank (deposits and retail government securities) exceeded HUF 350 billion, which is 5.6% higher than at the end of the previous year.

The Bank Group has significant refinancing on the liabilities side as a result of the intermediation of refinanced facilities.

Overall, the Bank remains Hungary's most liquid bank, with a loan-to-deposit ratio of around 50%, and loans are financed in a diversified funding structure.

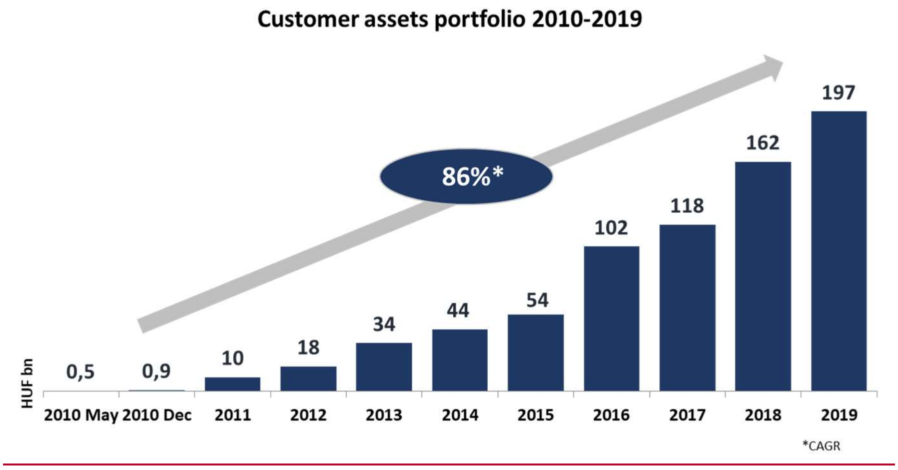
5.3. Receivables

On the asset side, the Bank Group maintained a significant amount of liquid assets in 2019 – central-bank and interbank deposits, government securities – in line with its prudent and conservative business policy. At the end of 2019, the Bank's securities portfolio exceeded 18% of the balance sheet total. This ratio is slightly lower than at the end of 2018 due to the more dynamically growing loan portfolio.

The Bank Group's loan portfolio is growing steadily every year, while the quality of the portfolio is constantly excellent

5.3.1. Lending

The Bank Group's customer assets portfolio (loans and corporate bonds) exceeded HUF 197 billion at the end of 2019, which was 22% higher than the previous year-end figure. The annual average growth in the asset portfolio from the Bank's foundation to the end of the reporting period was 86%.



The quality of the portfolio is excellent, and the Bank Group's asset portfolio is 99.96% problem-free. In 2019, the Bank Group recognised an impairment reversal of HUF 23 million in accordance with IFRS 9, which is the result of the expected-loss-based impairment methodology that forms the basis of the IFRS standard. The outstanding portfolio quality is due to the Bank's highly regulated and conservative risk-taking policies and practices.

In 2019, the Bank Group purchased a HUF 13.4 billion portfolio of NHP loans at a significant discount. The Bank strives to establish long-term customer relationships with performing customers, while non-performing customers and transactions are sold by the Bank, for which purpose it has entered into a contract with a company that specialises in receivables management.

The Bank is also an active participant in the MNB's Growth Loan Programme and Growth Bond Programme, and besides this, the Bank offers its customers the full range of lending products, from plain vanilla loans to complex financing facilities, in accordance with their needs.

5.4. Treasury

During the year, Treasury grew its business activity further while ensuring stable liquidity management remained a priority.

On the assets side, in parallel with the increase in loans, part of the asset-side activity of the balance sheet was managed by Treasury using money and capital market instruments. As part of this, the profit generated during the management of the securities portfolio contributed favourably to the Bank Group's annual result.

Prudent risk management is one of the key pillars of the Bank's business philosophy

During the year, the number of clients who entered into spot and forward foreign exchange (hedging) transactions at individual prices with the Bank's Treasury department grew further.

The Treasury also successfully used the MNB's changing set of tools in the management of the Bank Group's liquidity, exchange rate risk and interest rate risk, thus contributing significantly to the Bank Group's positive net earnings figure.

5.5. Risk management

The management of the Bank Group considers risk management to be key in terms of protecting depositors, operating profitably over the long term and thus increasing shareholder value. In its risk management standards, the Bank Group has taken a very conservative approach since its inception. One of the most important elements of the risk management policy is that there is virtually no purely collateral-based lending; all customers must primarily fund their loan repayments from cash flow, although in all cases the Bank Group tries to minimise credit risk by requesting additional collateral.

The primary objective of risk management is to protect the financial strength and reputation of the Bank Group, to contribute to the use of capital for competitive business activities, and thereby to increase shareholder value.

In its risk management system the Bank Group identifies, measures and analyses the various types of risk exposure of the Bank Group. During the process of risk management, the Bank Group processes the information, analyses the portfolio, formulates risk-taking rules, maintains a limit system, and operates the daily processes involved in risk management.
In the multi-stage business decision-making process for loan transactions, a thorough assessment is made of the macroeconomic environment, the customer's activity and the specified objective of the loan. In the course of this, the Bank Group pays special attention to providing financial instruments for the objectives of companies that, through their stable and efficient operation, create value for themselves and the economy as a whole.

Credit risk is the risk that the Bank Group will incur a loss due to the failure of the debtor, customer or partner to fulfil its contractual obligations to the bank. Before assuming credit risk, the Bank Group rates the creditworthiness of its customers and partners and classifies them into debtor and counterparty rating categories. Risks can only be undertaken with respect to customers of a suitable rating. The Bank Group regularly monitors the creditworthiness of customers and partners.

The Bank Group applies strict regulations regarding the range of eligible collaterals, the method used for their valuation and to collateral ratios. It uses a wide range of collateral to reduce risk, in particular loan guarantees, cash collateral, securities collateral, payment guarantees, mortgages, and pledges established on receivables and/or movable assets.

The Bank Group uses benchmark-based pricing or offers fixed interest-period schemes. As part of this process, in the case of self-funded loans the Bank applies regularly repriced, margin-based interest rates tied to a market reference rate and adjusted to the currency of the loan, in a manner that is transparent for the customer. For refinanced products, the Bank also minimises its interest rate risk. In the case of fixed interest rate schemes, the interest rate risk is covered by the Bank.
Market Risk Management works with the business departments to oversee the entire portfolio in terms of the matching of the repricing periods of liabilities and assets.

Ensuring liquidity is an essential element of the Bank Group's activity. The Bank Group ensures its liquidity by matching the maturities of its receivables and liabilities, and at the same time, while maintaining solvency at all times, it performs limit-restricted maturity transformations to help ensure the Bank's profitability.

The Bank Group aims to keep foreign exchange risk low, in line with both strategic and short-term business objectives. Depending on market conditions, open foreign exchange positions arising in the course of business are, wherever possible, hedged immediately.

The assessment of asset and liability matching is performed separately for each currency, to ensure the maintenance of matching by currency.

The Bank Group's trading book typically contains transactions aimed at the management of liquidity, the servicing of partner banks and customers and the conclusion of hedging transactions, primarily with spot FX and securities transactions and currency forwards.

Owing to its conservative product policy, at present the Bank does not deal in high-leverage options or volatile commodity and precious metal trades.

In the course of the risk management of liquid-market transactions, as a part of the limit system the partner bank and customer limits, margin requirements, decision-making levels and limits, and market variable-based exposure rates, are all regulated.

The objective of operational risk management is to support efforts to keep operating costs low, and to promote efficient organisational operation. The Bank primarily manages operational risks, concentrating on prevention, through the establishment of suitable internal regulations and procedures, the appropriate training of employees participating in the work processes, and the provision of built-in control mechanisms.

The after-tax profit of the Bank Group was HUF 1,118 million, 8% higher than the previous year's profit

Measurement of the levels of risk takes place through the continuous gathering of data on events that occur, and regular self-assessments based on forward-looking estimates made at the level of the individual departments. These surveys outline the patterns in the distribution of the events, thereby helping to identify the areas where intervention is necessary. The process is supported by a network of operational risk officers appointed in each department of the organisation.

5.6. Income statement

The Bank Group closed 2019 with an after-tax profit of HUF 1,118 million.

Net operating income increased by 16%

The net operating profit of HUF 6,572 million was 16%, or HUF 926 million, higher than in 2018, with the difference down to the net income generated by the growing business portfolio and the active use of banking services among customers. Within this, net interest income increased by 18%.

The increase in operating expenses was due to the growth in business activity, the implementation of digital innovations and to more intensive marketing activity, as well as to the increasing depreciation recorded on capital investments.

Profit and loss (HUF Bn)	2018	2019	Change
NET BUSINESS PROFIT	**5 647**	**6 572**	**116%**
Net interest income	2 634	3 104	118%
Net fee and commission income	1 358	1 747	129%
Other operating income and loss	-355	-367	103%
Credit loss and profit, Provisioning	-75	23	-31%
NET OPERATING PROFIT	**5 217**	**6 229**	**119%**
Operating expenses	-3 977	-4 853	122%
PROFIT BEFORE TAX	**1 240**	**1 376**	**111%**
Income taxes	-200	-258	129%
PROFIT AFTER TAX	**1 040**	**1 118**	**108%**

5.7. Significant events after the balance sheet date

The COVID-19 pandemic reached Europe, including Hungary, in March 2020. Depending on how long the crisis lasts, this could have a major impact on global economic growth in 2020, including growth in Hungary, which will also have an impact on the Bank Group's results. According to the current outlook, it may be hoped that the healthcare system will be able to treat those who fall sick properly, and thus in the case of Hungary, the emergency will last for a shorter time than the average and will result in a moderate decline in 2020. It is not even possible to give an approximate quantification of the effects on the basis of current information, but strong government and regulatory measures are expected to help offset the negative effects in the shortest possible time and put the economy back on a sustainable new growth path. At the same time, the situation that has arisen suggests there will be an acceleration in the spread of digital solutions both in terms of customer service and in the internal workflow of companies.

6. Overview of the Bank Group's business plan for 2020

The results of the last nine and a half years have confirmed that the implementation of the conservative portfolio building and digital banking strategy launched by the Bank Group in 2010 has been successful, and that the business model has been well received by customers. Accordingly, in the 2020 business year the Bank Group will continue its business operations in accordance with the approved 10-year strategic plan. The most important objective is to increase shareholder value through sustainable, balanced business and profit growth over the long term. Along with the digital strategy already launched, the Bank Group will continue to strengthen its market role, and increase its market share and its recognition.

The Bank Group continues to expect significant business expansion in 2020, similar to the performance of the previous period. This growth will be accompanied by a further increase in cost efficiency. The plan is to build a conservative loan portfolio by providing the appropriate stable resources and taking advantage of the available guarantee facilities.

The Bank Group plans to grow significantly above the market average, both in terms of customer loans and customer deposits. In addition to lending, the increase in customer numbers will also be driven by the growing awareness of the Bank among the public and through the constant development and launch of innovative new services. GRÁNIT Bank won a non-refundable grant within the framework of the "Support for Market-Driven R&D and Innovation Projects (2019-1.1.1-MARKET RDI)" tender, with its development concept for "A Progressive Payment Solution Focusing on Bulk Invoice Issuers".

In 2020, in addition to portfolio building, the Bank Group plans to implement developments that require more resources than before, partly in order to meet its statutory obligations (e.g. immediate payments, PSD2, etc.) and partly to expand its business opportunities.

The Bank Group's operations and results in 2020 will, whatever the case, be affected by the measures introduced due to the pandemic referred to above and by the slowdown in economic growth. GRÁNIT Bank has implemented an entirely digital model, meaning that the servicing of customers runs smoothly even in emergencies, and more than 80% of banking procedures can be performed from home, and thus in the current situation the digital business model is more valuable than ever. The Bank Group is continuously monitoring changes in its customers' financial situation and, in accordance with government and MNB measures, is striving to serve the changing needs of customers and to play an active role in countering the negative economic effects of the epidemic.

Budapest, 22 April 2020

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Board of Directors of GRÁNIT Bank Zrt.